INTERNATIONAL MONETARY FUND

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# HONDURAS

July 2019

## STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR A STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR HONDURAS

In the context of the Staff Report for the 2019 Article IV Consultation and Request for a Stand-By Arrangement and an Arrangement Under the Standby Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its July 15, 2019, consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 15, 2019, following discussions that ended on May 6, 2019, with the officials of Honduras on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 21, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Honduras.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Honduras*
Memorandum of Economic and Financial Policies by the authorities of Honduras*
Technical Memorandum of Understanding*
Selected Issues
*Also included in Staff Report.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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July 16, 2019

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Washington, D. C. 20431 USA

**IMF Executive Board Concludes 2019 Article IV Consultation with Honduras**

On July 1, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Honduras. At the same time, the Board approved two-year arrangements under the Stand-By Arrangement (SBA) and Standby Credit Facility (SCF) for Honduras; a press release on this was issued separately.

Supported by the Fund program during 2014-17, Honduras made great strides reducing macroeconomic imbalances and strengthening its policy framework. Confidence improved; and Honduras's debt spreads declined steadily and translated into better financing terms for private and public investment. Nevertheless, challenges remain to reduce vulnerabilities and risks, including the still high level of poverty and informality, the deteriorating financial situation of the public electricity company (ENEE), and the continued need to strengthen the macroeconomic policy framework and improve governance.

Macroeconomic conditions in Honduras remained stable in 2018. GDP growth slowed to 3¾ percent last year due to weaker terms of trade, but remained close to potential, supported by private consumption amid strong growth in remittances. Inflation is stable around the center of the central bank´s 4±1 percent target band. Owing to lower coffee prices and higher oil prices, the current account widened to 4¼ percent of GDP; but stayed close to its historical average. Despite a higher than expected deficit in the electricity company (ENEE), the nonfinancial public sector (NFPS) posted a deficit of 0.9 percent of GDP, in line with the target in the Fiscal Responsibility Law (FRL). The financial system is stable, liquid, and well capitalized, with NPLs at historic lows.

Going forward, the authorities' economic program aims at maintaining macroeconomic stability, while enacting economic and institutional reforms to foster inclusive growth. It is centered around three major priorities; securing the fiscal position by putting ENEE on a sustainable path while maintaining policy space for investment and social spending; strengthening monetary policy and financial institutions to buffer shocks; and implementing reforms to improve the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

business environment and governance, including by stepping up efforts in the fight against corruption.

In this context, while growth is projected to slow down to slightly less than 3½ percent in 2019—mainly owing to still weak terms of trade—reforms in the electricity sector, improved governance, and the continued strengthening of the macroeconomic policy framework would secure debt sustainability and support a recovery in investment; and positive confidence effects would foster GDP growth. Higher growth, public investment, and social spending would help reduce informality and narrow the gender gap. Inflation and inflation expectations are expected to converge towards the midpoint of the central bank target range, while the current account deficit is expected to remain stable at around 4 percent of GDP. The outlook is subject to downside risks, mainly from lower global growth, terms of trade shocks, tighter global financial conditions, and uncertainties associated with trade tensions and US immigration policies.

**Executive Board Assessment[2]**

Executive Directors agreed with the thrust of the staff appraisal. They commended Honduras' ambitious reform efforts in the last few years that resulted in macroeconomic stability, fiscal deficit reductions, strengthened institutional and policy frameworks, and improved investor confidence. Notwithstanding these achievements, Directors noted that high poverty and inequality, corruption, weak rule of law, and widespread violence remain major challenges. Addressing these challenges will support Honduras' pursuit of strong, sustainable, inclusive and pro-poor growth. In this context, Directors welcomed the authorities' economic reform program, which focuses on maintaining macroeconomic stability, while implementing reforms to foster inclusive growth and improve social conditions.

Directors commended the authorities' commitment to fiscal prudence—institutionalized by the Fiscal Responsibility Law—while protecting investment and social spending. They called for continued efforts at revenue mobilization—including through a revision of tax exemptions—and stronger tax administration and compliance. Together with measures to control expenditure over the medium term, Directors encouraged improved transparency and governance, including for trust funds, and sound public financial management. In that context, Directors positively noted the completion of the Fiscal Transparency Evaluation and the authorities' commitment to implement its recommendations.

Directors welcomed the authorities' recent reforms in the electricity sector, including a tariff adjustment with subsidies to protect the very poor. Noting that reducing financial imbalances would create space for much needed infrastructure and social spending, they encouraged further efforts to improve the sector's institutional framework and put the finances of the national electricity company (ENEE) on a sustainable path.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors commended the recent measures to modernize the monetary policy framework and make the exchange rate regime more flexible—notably by reducing foreign exchange surrender requirements. Moving forward, they encouraged a gradual transition to exchange rate flexibility and continued efforts in strengthening the central bank's operational autonomy and governance with a view to gradually transition toward inflation-targeting. Directors, thus, welcomed the authorities' plan to submit a new Central Bank Charter to Congress by year-end.

Directors noted that the financial system remains broadly stable, liquid, well-capitalized, and with NPLs at historic lows. Notwithstanding these developments, they encouraged its careful monitoring given foreign exchange credit growth and encouraged the authorities to continue to address the financial situation of the non-systemic agricultural development bank, BANADESA. Directors also appreciated the authorities' commitment to strengthening the AML/CFT framework in line with the Financial Action Task Force of Latin America's (GAFILAT) recommendations and called for more effective compliance.

Directors welcomed the authorities' focus on structural reforms to improve governance and the business climate, primarily by reducing the scope for corruption and strengthening the rule of law. Noting that such reforms would help foster medium-term inclusive growth, they welcomed programs to improve gender equality and female labor force participation rates and encouraged the authorities to strengthen these efforts.

It is expected that the next Article IV consultation with Honduras will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

## Honduras: Selected Economic Indicators

(Annual percentage change unless otherwise indicated)

| | 2014 | 2015 | 2016 | 2017 | Prel. 2018 | Proj. 2019 | Proj. 2020 |
|---|---|---|---|---|---|---|---|
| **National income and prices** | | | | | | | |
| GDP at constant prices | 3.1 | 3.8 | 3.8 | 4.9 | 3.7 | 3.4 | 3.5 |
| GDP deflator | 6.8 | 6.9 | 3.8 | 4.3 | 1.8 | 3.2 | 3.4 |
| Consumer prices (eop) | 5.8 | 2.4 | 3.3 | 4.7 | 4.2 | 4.4 | 4.2 |
| **Exchange rate (eop, depreciation -)** | | | | | | | |
| Lempiras per U.S. dollar 1/ | 21.6 | 22.4 | 23.5 | 23.6 | 24.3 | 24.5 | … |
| Real effective rate 2/ | 3.4 | 1.8 | -2.0 | -0.9 | 1.3 | 1.8 | … |
| **Money and credit** | | | | | | | |
| Private sector credit | 10.8 | 10.0 | 12.9 | 9.4 | 13.4 | 11.6 | 9.0 |
| Broad money | 13.3 | 9.0 | 15.6 | 12.8 | 8.3 | 9.0 | 11.0 |
| Lending rate (eop, in percent) 3/ 4/ | 15.9 | 14.0 | 14.3 | 14.6 | 14.1 | 14.1 | … |
| Deposit rate (eop, in percent) 4/ | 10.4 | 8.8 | 8.2 | 8.4 | 8.0 | … | … |
| **Nonfinancial public sector (percent of GDP)** | | | | | | | |
| Primary balance | -3.4 | 0.1 | 0.3 | 0.1 | 0.0 | 0.6 | 0.7 |
| Overall balance | -3.9 | -0.9 | -0.5 | -0.8 | -0.9 | -0.9 | -0.8 |
| Gross debt | 39.3 | 39.0 | 39.9 | 39.9 | 41.8 | 42.1 | 42.0 |
| **Saving and investment (percent of GDP)** | | | | | | | |
| Gross fixed capital formation | 23.0 | 26.4 | 23.4 | 24.3 | 25.7 | 25.7 | 26.9 |
| Gross national savings | 16.0 | 21.7 | 20.8 | 22.6 | 21.5 | 21.5 | 22.6 |
| **External sector** | | | | | | | |
| Gross international reserves (millions of dollars) | 3,698 | 4,187 | 4,488 | 5,088 | 5,147 | 5,288 | 5,456 |
| Gross international reserves (in months of imports) 5/ | 4.3 | 5.1 | 5.0 | 5.3 | 5.1 | 5.0 | 5.0 |
| Change in gross international reserves (increase -) | -459 | -303 | -66 | -884 | -50 | -141 | -168 |
| Current account balance (percent of GDP) | -6.9 | -4.7 | -2.6 | -1.8 | -4.2 | -4.2 | -4.3 |
| Exports f.o.b. | 4.0 | 1.3 | -3.2 | 8.6 | 0.3 | -0.4 | 3.1 |
| Imports f.o.b. | 1.2 | 0.8 | -5.5 | 7.2 | 7.7 | 2.8 | 3.9 |

Sources: Central Bank of Honduras, Ministry of Finance, and IMF staff estimates and projections.

1/ 2019 data as of May 31, 2019.

2/ 2019 data as of April 2019.

3/ Weighted average interest rates on loans to financial system in national currency excluding credit cards.

4/ 2019 data as of March 2019.

5/ Refers to the following year's imports of non-maquila and nonfactor services.

# HONDURAS

June 21, 2019

## STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR A STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY

## EXECUTIVE SUMMARY

**Context.** Since 2014—supported by a Fund program that expired in December 2017—Honduras has reduced macroeconomic imbalances, institutionalized fiscal prudence, and laid the groundwork for a modern monetary policy framework. The authorities are committed to maintain prudent policies and to build on previous achievements to make progress in solving long-standing issues. In this context, they have requested a new Fund program—to be treated as precautionary—as an anchor to support their economic and institutional reforms, which aim at increasing the quality of fiscal policy and improving governance and the business environment.

**Recent developments and outlook.** GDP growth reached 3¾ percent in 2018— supported by private consumption amid strong remittances—and inflation remained within the target band. The NFPS deficit, at 0.9 percent of GDP, overperformed the ceiling in the Fiscal Responsibility Law. The current account deteriorated due to declining terms of trade, but it remains close to the historical average. The financial system is stable and well capitalized. Staff projects GDP growth converging toward potential in the medium term; and continued macroeconomic stability.

**Article IV priorities.** Honduras needs to foster inclusive growth through reforms and better governance. Policy priorities include (1) reforms to increase the quality of fiscal policy, sustaining revenue mobilization efforts, protecting investment and social spending, and securing financial sustainability of the public electricity company, (2) reforms to enhance transparency and governance in the budget; (3) continued progress to modernize the monetary policy framework; and (4) efforts to strengthen governance and AML/CFT, bolster anti-corruption initiatives, and improve the business climate.

**Program Modalities.** The proposed program is a 24-month SBA/SCF with access of SDR 224.8 million, 90 percent of quota (about US$311 million). The program has semiannual reviews and the authorities intend to treat it as precautionary.

**Approved by:**
**Patricia Alonso-Gamo (WHD) and Ana Corbacho (SPR)**

Discussions were held in Washington, D.C. during April 9-13 and continued in Tegucigalpa and San Pedro Sula during April 22-May 6. The mission comprised E. Vesperoni (Head), N. Geng and J. Kapsoli (all WHD), F. Arizala (SPR), C. Alonso (FAD), and E. Bondarenko (World Bank). J. Suazo (OED) participated in the discussions. J. Puig, Resident Representative, assisted the mission while C. Koh and C. Friend provided support from headquarters.

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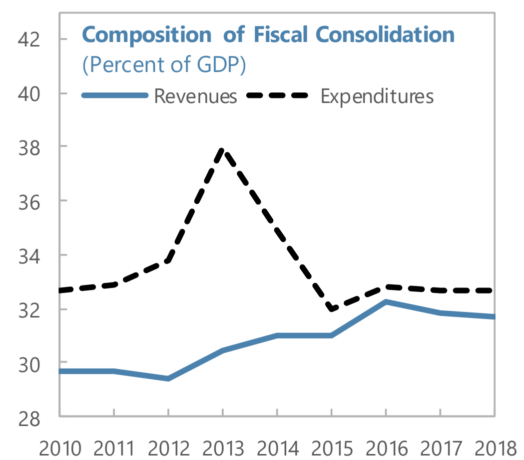
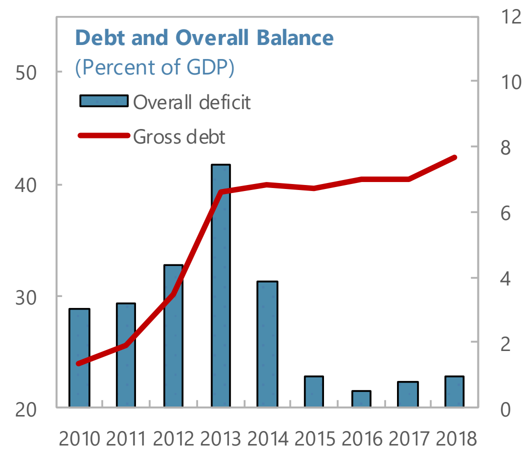
**APPENDIX**

# STABLE ECONOMIC CONDITIONS, BUT A NEED TO STRENGHTEN GOVERNANCE AND REDUCE POVERTY

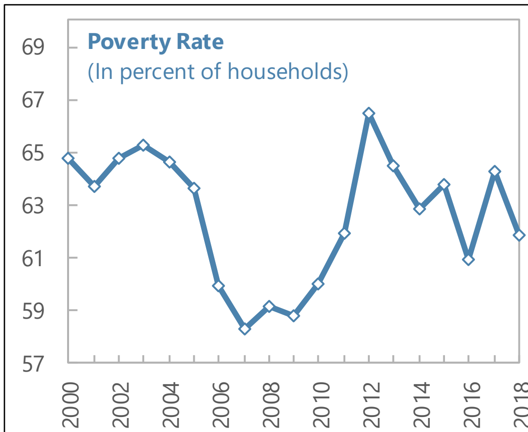
1. **Since 2014, Honduras has made significant progress in strengthening its policy framework in the context of sustained economic activity and macroeconomic stability.** In December 2017, Honduras completed a three-year IMF-supported program that managed to stabilize the economy and lay the groundwork for sustainable medium-term growth. The program institutionalized fiscal prudence, stabilized public debt, and introduced elements of a modern monetary policy framework with a view to move toward inflation targeting going forward. The economy grew in line with potential and inflation was stable. On the backdrop of an ambitious reform program, confidence improved—as reflected in steady credit ratings improvements—and reflected into better financing terms for private and public investment.




Sources: Ministry of Finance and IMF staff calculations.

2. **Despite this progress, though, poverty is still high and challenges that hinder medium-term growth remain.** A high level of poverty and weak productive capacity remain Honduras's main medium-term growth impediments. The poverty ratio has been around 60 percent for more than twenty years, making Honduras one of the poorest countries in the Western Hemisphere. This is rooted on structural issues, such as high informality, strong dependence on agriculture, and gang-related violence. And while through an overhaul of the police and a significant involvement of the armed forces the incidence of violent crime has declined markedly over the last few years, it remains above the Latin-American average.




Source: Honduras' National Institute of Statistics (INE)

**3. To address these challenges, policies should aim at fostering inclusive growth, building on previous achievements and strengthening institutions.** Upholding previous revenue mobilization efforts and implementing structural reforms—notably in the electricity sector, to put the finances of the public electricity company (ENEE) on a sustainable path—should create fiscal space to reduce the infrastructure gap and increase targeted pro-poor spending while maintaining the prudent fiscal position embedded in the Fiscal Responsibility Law (FRL). Against the backdrop of weak institutions, reforms to improve governance and anti-corruption initiatives will be critical.

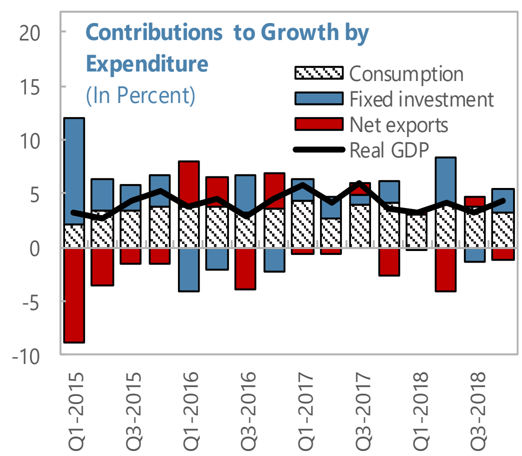
**4. The authorities have requested support from the Fund to foster their reform agenda.** The government controls 61 out of 128 seats in Congress—it could be supported by other small minority parties as well—and there has been political agreement on electoral reforms to make elections more transparent. In this context, the authorities intend to advance their economic and institutional reforms to achieve better governance and improve the business environment. The program will maintain fiscal prudence and strengthen the social safety net to protect early childhood and reduce the gender gap, securing support from civil society and other relevant stakeholders. To pursue this agenda, the authorities have requested support from the Fund, including through balance of payment financing if the need arises. The authorities' policy actions have been broadly consistent with past Fund advice (Annex V).

# RECENT DEVELOPMENTS, OUTLOOK AND RISKS

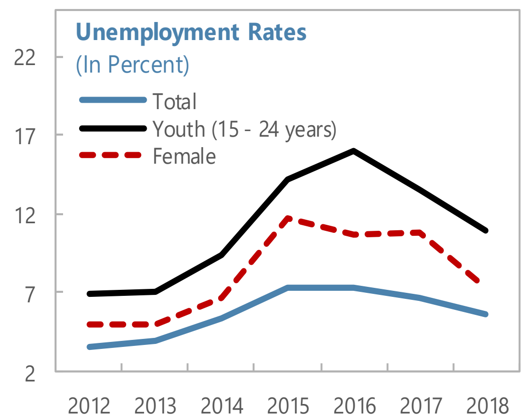
## A. Recent Developments

**5. The economy performed well in 2018 despite worsening terms of trade.** GDP growth reached 3¾ percent; a deceleration *vis-à-vis* its buoyant performance in 2017 but still close to potential. Lower growth was explained by declining terms of trade. Additionally, an adjustment in public investment to compensate for a large slippage in ENEE has significantly reduced its contribution to growth. From the supply side, the impact of declining terms of trade is apparent in agriculture—about 15 percent of GDP—where growth decelerated sharply, mainly due to the decreasing trend in coffee prices. The output gap is estimated to be slightly negative.

**6. The slowdown did not have a negative impact on unemployment in 2018, but underemployment has increased.** Despite weaker economic activity, the unemployment rate fell to 5¾ percent in 2018—6¾ percent in 2017—reflecting favorable trends in formal labor markets. However, challenges remain. Unemployment rates are higher for women and young workers, which fuel crime and migration. And underemployment—defined as full-time workers earning less than the minimum wage—has increased to 48½ percent in 2018 from 44¼ percent in 2017. This is most likely behind the decline in labor productivity that took place in 2018.

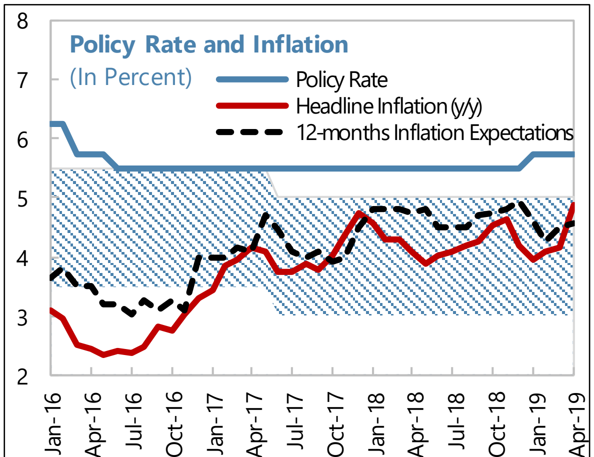



Sources: Central Bank of Honduras and IMF staff calculations.




Sources: Honduras' National Institute of Statistics (INE) and IMF staff calculations.

7. **Inflation stayed within the central bank's target band, but inflation expectations remained close to the upper bound in late 2018 and the central bank hiked the policy rate.** In 2018, the impact of higher oil prices and a significant adjustment in electricity tariffs in October was partially compensated by lower inflation in food and beverages, resulting in a 4¼ inflation rate at year-end. As inflation expectations kept hovering around the upper limit of the target band, the central bank (BCH) hiked the policy rate last January, the first hike since 2012. Inflation rebounded in April to 4.9 percent y/y—amid an 11 percent increase in the electricity tariff announced by the electricity regulatory body (CREE) in March—but core inflation remained stable.[1] The lempira depreciated by 3¼ percent against the U.S. dollar in 2018; and an additional ¼ percent during January-April 2019. However, the real effective exchange rate appreciated slightly, reflecting higher nominal depreciation and lower inflation in trading partners.

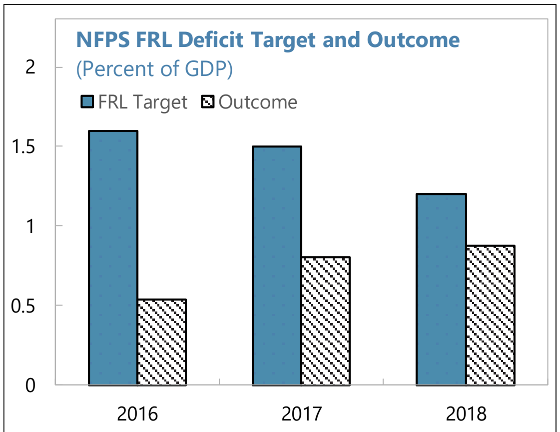



Sources: Central Bank of Honduras and IMF staff calculations.

8. **The nonfinancial public sector deficit was below the FRL ceiling in 2018, but the financial situation of ENEE has strained public finances and ultimately domestic demand.** The nonfinancial public sector (NFPS) deficit reached 0.9 percent of GDP in 2018—against the FRL ceiling of 1.2 percent of GDP. Given that the FRL ceiling applies to the NFPS deficit, a large increase in a deficit outside the central government would require a symmetric improvement at the central government to comply with it. In 2018, increasing oil prices and lack of progress in reducing

[1] The CREE performs quarterly updates of the generation component in the electricity tariff to ensure consistency with costs.

electricity losses resulted in a 1.2 percent of GDP deficit of ENEE (net of government subsidies), forcing a contraction in public investment, which dragged domestic demand and growth.[2]



Sources: Central Bank of Honduras and IMF staff calculations.

**9. The current account (CA) deficit widened to 4¼ percent of GDP.** This was driven by a large decline in the terms of trade associated with lower coffee prices and higher oil prices. The price of coffee—the main commodity export—reached its lowest level in more than a decade. Remittances continue to be critical to prevent a further deterioration in the CA deficit—growing by 11 percent in 2018, following record-high growth in 2017—driven by buoyant U.S. economic activity and precautionary savings associated with uncertainty about U.S. migration policy. During the first quarter of 2019, remittances continued to grow strongly at 10½ percent y/y. Net international reserves increased by US$67 million in 2018, keeping the gross reserves coverage ratio at slightly more than 5 months of non-maquila imports of goods and services and reserve adequacy at about 110 percent of the Fund's Reserve Adequacy Metric (ARA).

**10. The external position is broadly in line with medium-term fundamentals and desirable policies.** The EBA-lite model estimates a multilaterally consistent cyclically adjusted CA norm of -5.4 percent of GDP for 2018. This norm reflects the effects from lagging productivity growth, favorable demographics, high migrant share, and relatively high medium-term growth. The difference between the 2018 CA—adjusted by cyclical and temporary factors—and the CA norm leads to a gap of 0.7 percent of GDP, implying that the external position is broadly consistent with fundamentals and desirable policy settings (Annex I).

**11. The banking system is stable, liquid, and well capitalized, but dollarization remains high.** For the private banking system as a whole, bank capital is above regulatory requirements, NPLs are at record-low levels, and liquidity is ample. Following the agenda to implement Basel III, the banking commission (CNBS) has mandated an additional 2½ percent capital conservation buffer, of which ½ percent has already been implemented. The remaining 2 percent will be phased in by end-2022 at a pace of ¼ percentage point semiannually. Additionally, the CNBS has prepared a methodology to identify systemic banks, with the view of introducing further capital requirements. Although stable, dollarization remains high at about 30 percent, with around ⅔ of foreign currency credit to the nonfinancial private sector allocated to unhedged borrowers.

**12. Credit growth—particularly in foreign currency—accelerated in 2018.** Credit increased by 13½ percent and by 18 percent in foreign currency; and it remained buoyant in early 2019.[3] This

[2] Hondutel, the telecommunications company, also recorded a small deficit in 2018—less than 0.01 percent of GDP.

[3] FX credit is concentrated in industry, agriculture, and retail sectors. FX credit growth in 2018 reached 18½ percent for corporations, while it fell slightly for households.

reflected in part regulatory changes oriented to promote the implementation of private strategic investment projects—mainly in the energy sector—and ENEE's large accumulation of unpaid bills to private generators, which forced them to rely on bank credit to fund their operations.[4] As prices for energy corporations are indexed to the U.S. dollar and FX interest rates are lower than those in domestic currency, this prompted an increase in demand for credit in U.S. dollars.[5] Because of these developments, the Basel gap turned positive, indicating potential credit excess (Figure 4).

**Honduras: Financial Soundness Indicator Map**

| Honduras | 2016Q2 | 2016Q3 | 2016Q4 | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 | Latest |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Overall Financial Sector Rating | M | M | M | M | M | M | M | M | M | M | M | M |
| **Credit cycle** | L | L | L | L | L | L | L | L | L | M | n.a. | M |
| Change in credit / GDP ratio (pp, annual) | 0.7 | 1.2 | 1.6 | 1.2 | 0.8 | 0.5 | 0.1 | 1.3 | 2.5 | 3.6 | n.a. | 3.6 |
| Growth of credit / GDP (%, annual) | 1.3 | 2.2 | 3.0 | 2.2 | 1.5 | 0.8 | 0.2 | 2.3 | 4.5 | 6.5 | n.a. | 6.5 |
| Credit-to-GDP gap (st. dev) | -1.1 | -0.9 | -0.6 | -0.5 | -0.4 | -0.2 | 0.0 | 1.4 | 2.2 | 2.4 | n.a. | 2.4 |
| **Balance Sheet Soundness** | M | M | M | M | M | M | M | M | M | M | M | M |
| **Balance Sheet Structural Risk** | M | M | M | M | M | M | M | M | M | M | M | M |
| *Deposit-to-loan ratio* | 98.3 | 96.9 | 97.3 | 101.4 | 101.3 | 101.0 | 98.7 | 100.6 | 97.6 | n.a. | n.a. | 97.6 |
| *FX liabilities % (of total liabilities)* | 35.3 | 35.2 | 35.3 | 31.8 | 31.3 | 31.1 | 31.3 | 30.7 | 31.4 | 29.8 | 28.9 | 28.9 |
| *FX loans % (of total loans)* | 31.0 | 30.8 | 31.4 | 31.6 | 30.3 | 29.7 | 30.5 | 31.6 | 31.6 | 32.4 | 31.9 | 31.9 |
| **Balance Sheet Buffers** | L | L | L | L | L | L | L | L | L | L | L | L |
| ***Leverage*** | L | L | L | L | L | L | L | L | L | n.a. | n.a. | L |
| Leverage ratio (%) | 10.4 | 10.4 | 10.4 | 10.9 | 10.8 | 10.9 | 11.0 | 11.2 | 11.1 | n.a. | n.a. | 11.1 |
| ***Profitability*** | L | L | L | L | L | L | L | L | L | L | L | L |
| ROA | 2.3 | 2.6 | 2.0 | 2.0 | 2.0 | 1.9 | 2.0 | 1.9 | 1.9 | 1.2 | 1.1 | 1.1 |
| ROE | 22.6 | 25.5 | 21.1 | 19.2 | 19.3 | 18.7 | 19.7 | 18.1 | 18.9 | 12.5 | 11.5 | 11.5 |
| ***Asset quality*** | M | L | L | L | L | L | L | L | L | L | L | L |
| NPL ratio | 3.6 | 3.5 | 2.9 | 2.6 | 2.5 | 2.5 | 2.4 | 2.3 | 2.4 | 2.3 | 2.1 | 2.1 |
| NPL ratio change (%, annual) | 8.4 | -4.9 | -4.4 | -30.5 | -31.2 | -27.9 | -19.1 | -10.1 | -4.4 | -7.7 | -9.9 | -9.9 |

| Memo items: | 2016Q2 | 2016Q3 | 2016Q4 | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 | Latest |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Credit-to-GDP (%) | 55.2 | 55.6 | 56.0 | 56.0 | 56.1 | 56.1 | 56.1 | 57.3 | 58.6 | 59.7 | n.a. | 59.7 |
| Credit-to-GDP gap (%; HP filter) | -1.2 | -1.0 | 0.3 | -0.5 | -1.4 | -1.6 | -1.3 | -0.3 | 0.3 | 1.0 | n.a. | 1.0 |
| Credit growth (%; annual) | 10.5 | 10.5 | 10.6 | 10.3 | 9.9 | 9.6 | 9.4 | 11.1 | 12.7 | 14.3 | n.a. | 14.3 |
| CAR (in %) | 14.2 | 14.0 | 14.1 | 14.0 | 13.8 | 13.9 | 14.0 | 14.2 | 13.8 | 13.4 | 13.4 | 13.4 |

## B. Outlook and Risks

**13. Growth is expected to decelerate in 2019, but gradually converge toward potential over the medium term.** Growth is projected to slow down to slightly less than 3½ percent in 2019, owing to still weak terms of trade and sluggish public investment due to the need to support ENEE's consolidation efforts. In coming years, reforms in the electricity sector, improved governance, and the continued strengthening of the macroeconomic policy framework will support the recovery in investment; and positive confidence effects will foster GDP growth. Higher growth, public investment, and social spending will help reduce informality and narrow the gender gap. Inflation and inflation expectations are expected to converge toward the midpoint of the BCH's target band, and the current account deficit is expected to hover around 4 percent of GDP. Reserve adequacy is projected to remain within the recommended 100-150 percent range of the ARA metric.

[4] The CNBS reduced risk weights attached to FX loans for national strategic projects in 2016 and 2018.

[5] Despite this credit acceleration, deposit and credit dollarization remain similar, at about 30 percent of the total.

**14. The fiscal position is expected to remain anchored by the FRL.** Tax policy measures introduced in the 2017 tax code and the phasing out of the minimum income tax will put a toll on tax collection in 2019 and 2020, with an estimated medium-term loss of ¾ percent of GDP.[6] Aiming to protect the hard-won achievements of the last program, the authorities are determined to reduce the large amount of tax exemptions to compensate the shortfall. Over the medium term, the authorities' economic program should secure debt sustainability while creating fiscal space for investment and social spending. Persistent revenue mobilization efforts and reforms in the electricity sector would keep the fiscal stance slightly below the FRL target, improving the primary balance, keeping financing costs at bay, and putting public debt on a declining path.

**Tax Policy Measures 2019**
(Percent of GDP)

| | |
|---|---|
| Reduction in tax basis for PIT | 0.0 |
| VAT exemption for agricultural goods | -0.1 |
| Reduction in tariffs (trade agreements) | 0.0 |
| Phase out corporate minimum income tax | -0.2 |
| Change from worldwide to local income for CIT | -0.1 |
| **Total** | **-0.5** |

Source: Ministry of Finance and Fund staff estimates

**15. Macroeconomic performance so far in 2019 appears on track with program targets.** On the monetary side, end-May NIR have increased by US$223 million.[7] On the fiscal side, both tax collection and the deficit of the central government are in line with projections. The CREE is applying tariff adjustments in line with regulations—tariffs for households increased by about 19 and 11 percent in late-2018 and April 2019 respectively.

**Honduras: Macroeconomic Outlook**

| | Act. | | Prel. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| | (Annual percent change) | | | | | | | | |
| **Output and Inflation** | | | | | | | | | |
| GDP at constant prices | 3.8 | 4.9 | 3.7 | 3.4 | 3.5 | 3.6 | 3.7 | 3.9 | 3.9 |
| Consumer prices (eop) | 3.3 | 4.7 | 4.2 | 4.4 | 4.2 | 4.0 | 4.0 | 4.0 | 4.0 |
| | (In percent of GDP, otherwise indicated) | | | | | | | | |
| **Nonfinancial Public Sector** | | | | | | | | | |
| Net lending (+) / Net borrowing (-) | -0.5 | -0.8 | -0.9 | -0.9 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 |
| Primary balance | 0.3 | 0.1 | 0.0 | 0.6 | 0.7 | 0.8 | 1.0 | 0.9 | 0.9 |
| Gross debt | 39.9 | 39.9 | 41.8 | 42.1 | 42.0 | 41.9 | 41.4 | 40.9 | 39.9 |
| Public Investment | 3.2 | 4.3 | 4.2 | 3.8 | 4.1 | 4.5 | 4.4 | 4.6 | 4.7 |
| **External sector** | | | | | | | | | |
| Current account balance | -2.6 | -1.8 | -4.2 | -4.2 | -4.3 | -4.2 | -4.1 | -3.9 | -3.9 |
| Oil price (in U.S. dollars) | 42.8 | 52.8 | 68.3 | 54.1 | 55.2 | 55.9 | 56.6 | 57.4 | 58.1 |
| GIR (in months of non maquila imports) | 5.0 | 5.3 | 5.1 | 5.0 | 5.0 | 5.0 | 5.0 | 5.1 | 5.1 |

Sources: Central Bank of Honduras, Ministry of Finance, and Fund staff estimates and projections.

[6] The short-term impact is lower as the minimum income tax will be phased out in three stages, finalizing in 2020.

[7] Corresponds to non-borrowed reserves as defined in the Technical Memorandum of Understanding (TMU).

**16. Risks to the projections are largely on the downside** (Annex III):

- *External risks.* Downside risks stem from global growth and policy uncertainties associated with trade tensions and changes in U.S. migration policies. Swings in energy prices may affect the external and fiscal positions; and lower global growth—particularly in the United States—or tighter migration policies would weaken remittances and domestic consumption. Tightening global financial conditions could trigger capital outflows.

- *Domestic risks.* Reforms in the electricity sector—involving significant institutional changes; and operational and financial challenges—are complex, giving place to implementation risks. Likewise, should social conditions weaken, it may reduce consensus for reforms.

***Authorities' Views***

**17. The authorities shared the staff's views regarding the outlook and risks.** The authorities stressed the challenge posed by low international coffee prices, which affect living conditions for coffee producers who are incurring losses at current prices. The authorities emphasized that the plunge in prices comes at a time in which the industry is still recovering from the outburst of coffee rust; and that the impact on low-income farmers could further increase migration pressures to the United States. They noticed that poverty indicators based on income may not capture the multidimensional aspect of this challenge; and that they are working with multilateral partners to improve poverty measures.

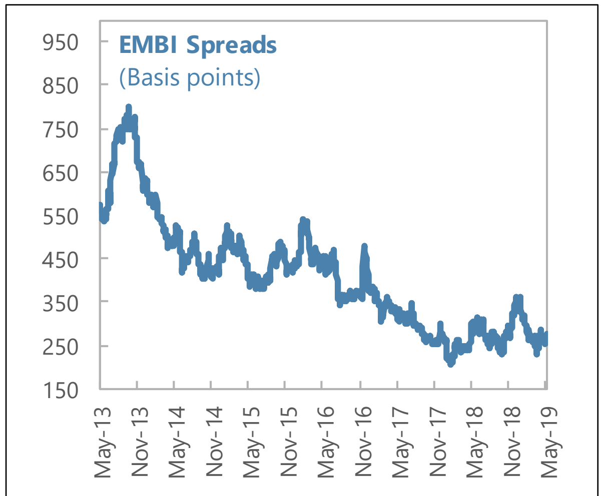
**18. The authorities agreed that the acceleration in private credit deserves careful monitoring.** However, they remain confident that credit growth will wind down gradually, as strategic projects are scheduled to be concluded early next year. They also highlighted their vigilant approach on NPLs; and are committed to act with macroprudential measures if needed.

# POLICY DISCUSSIONS: MAINTAINING STABILITY AND BUTRESSING INCLUSIVE GROWTH

**19. The authorities' economic program focuses on policies and structural reforms to reduce vulnerabilities and strengthen the foundations for inclusive growth.** Discussions emphasized the importance of a sound policy mix and reforms to: (i) secure the fiscal position by putting ENEE on a sustainable path while maintaining policy space for investment and social spending, (ii) continue building a monetary and financial policy framework to buffer shocks and maintain stability, and (iii) improve the business environment. A cross-cutting issue within these areas is the need to improve governance and transparency, relevant on central banking issues, public finance management, tax compliance, the electricity sector, and the rule of law.

## A. Maintaining Macroeconomic Stability

**20. The authorities reiterated their commitment to the FRL, which will continue guiding fiscal policy to secure debt sustainability.** Since the inception of the law in 2016, adherence to it has played a critical role, paving the way to putting public debt on a sustainable path and signaling fiscal prudence—notably through the electoral cycle in 2017, in which the authorities overperformed the law's deficit ceiling. Despite the significant challenges raised by ENEE's financial situation last year, the deficit was again below the ceiling, and the target on current spending was met. The fiscal prudence embedded in the FRL has been instrumental to achieve the significant fall in Honduras' credit spreads over the last years, which helped reduce both the financial cost of the treasury and interest rates for private investment financing. In line with this, the authorities' program envisages strict adherence to the FRL in the coming years; and aims at maintaining the deficit of the NFPS slightly below the ceiling established in the law to secure a sustainable path for public debt.



Source: Bloomberg

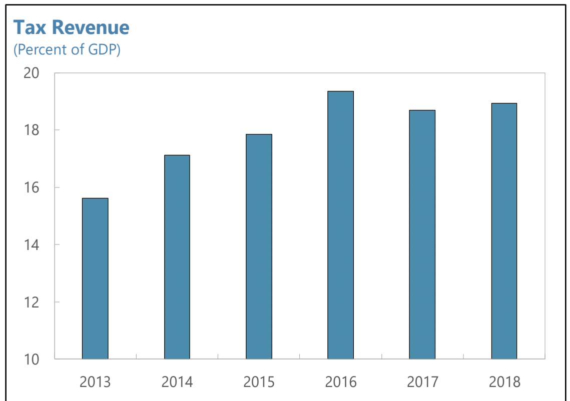
**21. Following the recent increase in the policy rate, the monetary authorities are committed to remain vigilant.** The recent tightening of monetary policy is consistent with the higher policy rate in the U.S. and inflation expectations that are close to the upper bound of the central bank's target band. While alternative estimates of the neutral monetary policy stance suggest that the policy interest rate may be slightly below the neutral level, the cyclical position of the Honduran economy suggest that is likely appropriate. The authorities have emphasized that they will remain vigilant to assess whether the evolution of global financial conditions, as well as inflation and inflation expectations, warrant further adjustments in the policy rate. They have also noted that macroprudential polices should be the first line of defense to address the rapid credit growth if the expected deceleration fails to materialize.

## B. Securing the Fiscal Position While Protecting Investment and Social Spending

**22. The authorities fiscal program aims at supporting reforms in the electricity sector while protecting the fiscal space needed for investment and social spending.** While the FRL provides an appropriate medium-term anchor to secure debt sustainability, increasing the quality of fiscal policy calls for addressing challenges from a potential weakening of the revenue envelope and the large deterioration of ENEE's financial position. The authorities' program does not envisage new taxes or increases in statutory rates—Honduras performs well in terms of collection compared to peers, with statutory rates in line with the region (Box 1)—but it includes efforts to maintain revenue mobilization efforts by broadening the tax base. It also includes deep reforms in the electricity sector, which will require a compromise from the different stakeholders to put the financial situation of ENEE on a sustainable path.

## Box 1. Revenue Mobilization in Honduras

**Honduras has made substantial progress on revenue mobilization.** Between 2013 and 2018, the tax revenue to GDP ratio rose by 3½ percentage points, from 15.0 percent to 18½ percent, with almost 60 percent explained by taxes on goods and services and 30 percent by the corporate income tax. These revenue mobilization efforts are critical, given Honduras poverty rates and developmental needs—GDP growth remained strong over the period, in line with empirical evidence suggesting relatively low tax multipliers and positive effects of fiscal consolidation on economic activity, particularly when it stabilizes public debt.



Sources: National authorities and IMF staff calculations.

**Tax rates are broadly in line with the region.** The corporate income tax rate in Honduras is among the lowest in the region—at 25 percent—although it is complemented by a 5 percent surtax that applies only to the most profitable companies. On value added and personal income tax, the rate is slightly higher than regional averages.

**Efficiency analysis shows that Honduras compares favorably against peers.** An efficiency frontier was calculated for a large sample of emerging and developing countries (see Honduras—Selected Analytical Issues, 2019). This analysis estimates an efficiency frontier based on a production function in which the tax effort is the output and GDP per capita, the size of the formal economy, the level of corruption, the educational level of the population, and the size of public spending are inputs. All countries in the sample are benchmarked against the frontier to calculate efficiency gaps. Closing the gap for Honduras could raise tax collection by 4 percent of GDP—less than in regional peers—and should be seen as a long-term target.

### Revenue Mobilization Efforts and Fiscal Discipline

**23. Recent tax policy measures have had an impact on tax revenues.** The enactment of a new tax code in 2017 has weakened the coercive powers of the tax authority. The code modified the process to apply criminal sanctions for tax fraud, weakened the framework to control exemptions, and made noncompliance notification procedures to taxpayers less efficient. It also introduced a large tax amnesty, which has been extended periodically. In 2018, a modification of the corporate income tax has resulted in a gradual phase out of the minimum corporate income tax. All these measures would imply a permanent reduction in tax collection, estimated at ¾ percent of GDP.

**24. Tax expenditures are the largest in the region.** These benefits have a significant fiscal cost—at almost 7 percent of GDP; about 60 percent of which is explained by exemptions associated with the VAT, and the rest by both income taxes and excises. The authorities have increased social awareness about their impact on the budget over the last year; shaping a broad consensus that some of these benefits should be revisited. Given that the tax burden is above the regional average and statutory rates seem aligned with peers, streamlining them offers a viable option to protect the revenue envelope—the FRL and the tax code include a framework to remove exemptions for companies that cannot show verifiable impacts on employment and growth.

**Tax Expenditures**
(In percent of GDP)

| | |
|---|---|
| **Income tax** | **2.2** |
| *o/w special regimes* | *1.1* |
| *o/w teachers* | *0.2* |
| *o/w energy sector* | *0.2* |
| **VAT** | **4.1** |
| *o/w food basket* | *1.2* |
| *o/w agriculture* | *0.2* |
| *o/w special regimes* | *0.2* |
| *o/w credit cards* | *0.1* |
| **Excise tax** | **0.4** |
| *o/w thermal generators* | *0.4* |
| *o/w ZOLITUR* | *0.1* |
| **Custom duties** | **0.1** |
| **Total** | **6.8** |

Source: Honduran Tax Authority.

**25. The authorities' program aims at maintaining revenue mobilization efforts both through a broadening of the tax base and a strengthening of tax administration.** After a projected decline in 2019, several measures will boost central government's tax collection to the levels reached last year—at 18½ percent of GDP—by 2021. The main elements of the authorities' plan can be summarized as follows:

- *Tax Expenditures*. The authorities are committed to remove some income tax exemptions while protecting the poor by preserving VAT exemptions for food staples. The authorities also plan to strengthen controls with a view of eliminating the abuse of some tax benefits—notably, exemptions benefiting companies located in export-processing zones that sell products in the local market, unfairly competing with companies (particularly SMEs) operating under general tax regulations.

- *Tax and customs administration*. The authorities plan not to issue new tax amnesties or widen the scope for the rescheduling of tax liabilities under the current regime. They also seek to (i) modify the tax code to allow electronic notification of tax noncompliance; (ii) finalize the intervention of the customs office by creating a new customs administration agency, and (iii) reinforce exemptions' control by transferring verification procedures from the treasury to the tax authority.

- *Modernization of tax procedures*. The program aims at replacing the obsolete and costly system of exempted purchase orders with a modern framework based on refunds. This change will not only strengthen the control of VAT exemptions, but also eliminate one of the most bureaucratic and lengthy procedures in Honduras. This decision is also part of the administrative rationalization policy that will reduce red tape and the cost of doing business, thus increasing competitiveness.

**26. The program will complement the framework in the FRL by strengthening public expenditure management.** While the ceiling on current expenditure growth in the FRL is instrumental at keeping public spending at bay, the authorities plan to introduce a centralized wage bargaining mechanism to guide decisions on nominal wage increases. Additionally, they expect to limit spending in goods and services by prioritizing travels and rationalizing temporary contracts and consultancy services. Over the medium-term, the authorities plan to upgrade the general directorate of the civil service to create a public administration national authority. The new entity will revisit the myriad of labor frameworks currently in place—including in decentralized agencies—to establish a modern civil service career, based on merit and nonpartisan principles.

**Central Government: Revenue and Expenditure**
(Percent of GDP)

| | 2019 | 2020 | 2021 |
|---|---|---|---|
| **Tax Collection** | | | |
| *No Adjustment* | *18.0* | *17.8* | *17.7* |
| *Measures to Broaden the Tax Base* | *0.1* | *0.8* | *0.9* |
| *Authorities Program* | *18.1* | *18.5* | *18.5* |
| **Government Consumption** | | | |
| *No Adjustment* | *11.1* | *11.2* | *11.2* |
| *Expenditure Control* | -0.8 | -0.9 | -1.0 |
| *Authorities Program* | *10.4* | *10.3* | *10.2* |
| **Social Spending** | | | |
| *No Adjustment* | *1.6* | *1.6* | *1.6* |
| *Authorities Program* | 2.0 | 2.2 | 2.3 |
| **Investment** | | | |
| *No Adjustment* | *1.4* | *1.6* | *1.7* |
| *Authorities Program* | 2.0 | 2.2 | 2.3 |

## Reforms in the Electricity Sector: Making ENEE's Finances Sustainable

**27. Despite efforts during the previous Fund-supported program, ENEE's financial situation has deteriorated.** Efforts to rightsize the workforce and low oil prices during 2014-16 had improved ENEE's operational balances. However, an increase in oil prices and lack of progress in addressing structural issues have partially reversed previous gains recently, and arrears to private sector generators have mounted over the last year. The weakening in ENEE's finances arises from below-cost tariff setting, large electricity losses, and high generation costs (Box 2).

**28. The authorities' plan aims at resolving the complex structural challenges in the electricity sector.** The road map is based on the agreement signed by the government, the banking association, the generators association, the business association, and ENEE in October 2018. The plan involves both institutional reforms, as well as operational and financial measures that will require compromises both from ENEE and from key stakeholders in the electricity sector—private generators and banks, among others. The cornerstone of the institutional reforms is the implementation of the 2014 electricity sector general framework law, and in particular the strengthening of the independent regulatory body and the creation of a system administrator for the electricity sector. Operational and financial measures focus on improving governance and strategic planning in ENEE, revamping the strategy to reduce losses, and reprofiling ENEE's debt to reduce financial costs and extend maturity.

### Box 2. ENEE's Financial Situation

**The deteriorating financial situation in ENEE has given place to a sharp increase in debt.** The increase in ENEE's deficit is partly explained by poor management of tariffs, which were oftentimes set at levels below cost recovery—this was compounded by several decrees exempting, *inter alia*, chapels, churches, nursing homes, and soccer fields from paying electricity. Adding to this, electricity losses have soared to about 35 percent in 2018, about twice the average in the region (excluding Honduras). Finally, higher oil prices increased generation costs and lack of strategic planning led to operational inefficiencies and excess supply of energy—installed capacity grew by 45.7 percent between 2013 and 2018, while demand only expanded by 20 percent. Moreover, adding to the challenges of long-term purchasing agreements (PPAs) with onerous costs and take-or-pay clauses, there are several PPAs approved by the Congress—not yet implemented—that could double the existing capacity. Due to persistent financial losses, ENEE has relied on bank financing to fund its deficits. Over time, to guarantee repayment of this debt, ENEE agreed to deposit income flows in a trust fund—losing control of its own cash flow and incurring arrears with generators. As a result, the financial situation of ENEE has turned unsustainable—debt increased to almost 10 percent of GDP.

**Empresa Nacional de Energía Eléctrica: Balance and Debt, 2010-18 1/**
**(Percent of GDP)**

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|
| Fiscal balance | 0.4 | -0.3 | -1.0 | -1.8 | -1.1 | -0.3 | -0.3 | -0.6 | -1.0 |
| Total debt | 0.0 | 2.7 | 2.6 | 3.8 | 4.9 | 5.0 | 6.0 | 7.6 | 9.6 |

1/ Includes subsidies from the Treasury.

29. **The reduction of ENEE's imbalances will be gradual; and the company will require support from the treasury in the short-term.** While institutional reforms will put the electricity sector on a sound footing over the medium term, they will likely have no immediate impact on ENEE's cash flow. The latter will rather benefit from the reduction in electricity losses, as well as generation and financial costs. The program targets an overall deficit of ENEE—excluding government subsidies—of 1.0 and 0.8 percent of GDP in 2019 and 2020 respectively. To this end, the program factors in higher revenues coming mostly from the reduction in electricity losses, estimated at 4 percent during 2019-2020.[8] Temporary transfers from the treasury to compensate ENEE for the difference between the current electricity losses and the amount that the company can pass-through to tariffs will be reflected in the budget.

30. **The main elements of the energy sector reform are:**

- *Institutional reforms in the electricity sector.* The authorities will adopt a three-pronged approach, including: (i) a new tariff scheme—prepared with assistance from the World Bank—that will update the current level of generation, distribution, transmission, and other costs to provide electricity services; (ii) stronger operational and budgetary autonomy of the electricity regulatory body (CREE), which will continue to enact quarterly tariff adjustments to ensure that prices are aligned with operational costs; and (iii) the creation of a system operator as a

[8] There are upside risks to this scenario, depending on the outcome of the discussions on generation costs and the financial restructuring of ENEE's liabilities.

dispatch center, to ensure a reliable delivery of electricity—a function that is currently performed by ENEE.[9]

- *Unbundling of ENEE.* The company will be separated in subsidiaries for distribution, transmission, and generation. This separation should increase transparency and improve governance and efficiency, fostering investment in transmission and distribution.

- *Operational and financial measures.* In strict adherence to Honduras's legal framework, the authorities will seek a more efficient generation—including the revision of approved contracts not yet in operation to prevent the materialization of contingencies—and savings in the cost of energy purchases through bilateral discussions with energy generators. Aided by concessional financing, the plan also envisages market-friendly refinancing agreements with ENEE's creditors to reduce financing costs and regain control of the company's cash flow. Finally, aided by multilateral guarantees, a new payment mechanism to ENEE's providers and creditors will be implemented to prevent the accumulation of arrears.

- *Reduction of electricity losses.* The authorities plan to revise, following due process, the contract with *Empresa Energía Honduras* (EEH)—the operator of the distribution system—to revamp the losses reduction plan. They intend to deploy a law enforcement taskforce to strengthen controls over theft and fraud; and upgrade the infrastructure plan to renew transmission and distribution equipment.

**31. The electricity sector reform will be communicated clearly; and it will include appropriate support for the poor.** The plan will clearly state its long-term objectives—in consultation with key stakeholders—and measures will be appropriately phased. Moreover, specific programs to protect the poor have been put in place already, including by maintaining the electricity subsidy for those consuming less than 75kwh per month and by introducing transitory budgetary transfers for low-consumption households.

### Fiscal Financing

**32. The fiscal program is fully financed.** Most financing is expected to come from external sources, particularly the Inter-American Development Bank (IDB), the Central-American Bank for Economic Integration (CABEI), and the World Bank (WB). Multilateral development banks are expected to disburse about US$1.2 billion during 2019-2021. Bilateral sources are also important in the financing plan. All other financing needs would come from tapping international markets, aided by solid fundamentals and steadfast program implementation.

[9] The process of strengthening the CREE has already begun. The regulatory body has been regularly updating tariffs since the third quarter of 2018. Tariffs for households were increased by about 19 percent in October 2018 and 11 percent in April this year. In both cases, the government introduced temporary subsides for all consumers to ensure higher tariffs were transferred only gradually.

**33. The authorities plan to clear domestic arrears.** ENEE's financial difficulties have given place to large arrears with private generators. As of March 2019, these arrears amount to 1¾ percent of GDP. The authorities aim at clearing them gradually as the financial situation of ENEE improves, in line with successful program implementation.

## C. Expenditure Quality, Transparency and Governance

**34. Recent initiatives increased transparency, strengthened the operation of the budget, and facilitated monitoring of FRL rules.** The Treasury has introduced a module into its Integrated Financial Management Information System (SIAFI)—allowing it to allot monthly operational ceilings in line with the FRL—as well as an inventory of trust funds that is disseminated using the treasury webpage. It has also put in place a small team to work as a unit of norms and processes in the budget directorate. The team should be the embryo of an expenditure quality unit to revamp performance budget pilots in the near future. Its immediate task is to identify specific sectors and relevant indicators with their corresponding baselines to carry out the pilots.

**35. To gather social support for reforms, the authorities' program aims at enhancing governance and transparency in public finance management.** Previous Fund advice and the recent Fiscal Transparency Evaluation (FTE) have helped identifying areas for improvement, notably regarding trust funds. Benchmarking of Honduras's reporting, projections, and risk management against the Fund's fiscal transparency code suggests that most practices are consistent with it, but room for improvement was found with respect to: (i) building comprehensive fiscal reports on operations and financing, (ii) enhancing the unity and accuracy of the budget, and (iii) improving risk management capacity by anticipating risks from trust funds and by actively monitoring risks related to SOEs.

**36. The authorities intend to implement sequential measures to improve transparency and governance in public spending:**

- *Trust Funds.* The authorities see the fulfillment of the budget unity principle as a medium-term goal. However, they are committed to include an annex on spending by trust funds as part of the 2020 budget bundle; and to fully incorporate all social trust funds into the 2021 budget. Additionally, as some trust funds are creating contingencies by taking debt that is not recorded by the treasury, the authorities seek to introduce a mandatory assessment from the treasury as a pre-condition to contract debt.

- *Fiscal Risks.* The plan includes the strengthening of the fiscal contingency unit, with a view to publish an annual fiscal risks statement that would include proposed policies to address risks with high probability of materialization; and to expand coverage to risks from SOEs.

- *Other Fiscal Governance Issues.* The authorities have requested further Fund technical assistance on governance issues, which includes—beyond trust funds and fiscal risks—issues related with procurement and the selection of public investment projects. The authorities are committed to assess recommendations of this assistance to discuss during the first review of the program a plan to tackle them.

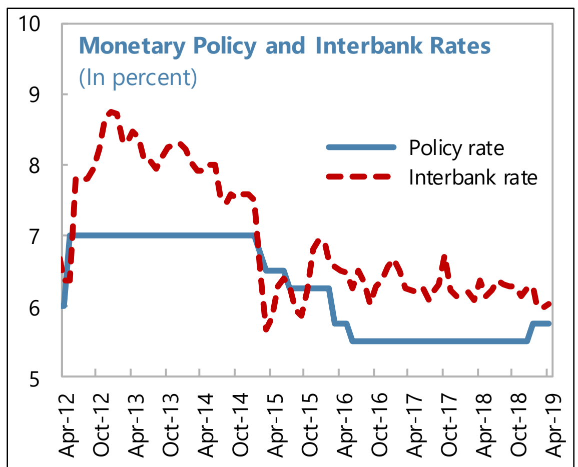
## D. Buffering Shocks and Ensuring Financial Stability

**37. Monetary policy will be in line with program targets.** The BCH plans to keep liquidity—net domestic assets—in line with its monetary program and the target on international reserves. Additionally, the program envisages a zero limit on financing to the public sector, as well as no new financing to BANHPROVI beyond what is authorized in the trust fund created in 2008.[10]

### Strengthening Monetary Policy Institutions

**38. The BCH's balance sheet has improved with the implementation of the recapitalization agreement signed with the treasury.** The agreement compensated the BCH for operational losses incurred during the period 2008-2011—about US$125 million—through the injection of interest-bearing securities. Additionally, it swapped a stock of US$450 million zero-coupon bonds—which covered BCH's losses prior to 2003 and the 2004-2006 period—with new interest bearing 5-year securities. The swap was done gradually and concluded in December 2018. The agreement also stated that the treasury will compensate annually any operational losses incurred after 2012 starting in 2019; and it authorized the use of treasury securities to conduct open market operations.

**39. The authorities are planning to build on recent progress in the transition toward inflation targeting.** The BCH has introduced transactions with collateralized securities in the interbank market, reduced FX surrender requirements by 30 percent, and strengthened its technical capacity to prepare a Forecasting and Policy Analysis System (FPAS). It has also introduced an electronic platform for interbank operations. This progress has facilitated a reduction of the gap between the central bank's policy rate and the interbank rate, which will strengthen monetary policy transmission. Going forward, the authorities' plan envisages strengthening the coordination between the treasury and the central bank to increase efficiency in money markets by reducing fragmentation between central bank and treasury instruments. In line with this, they will assess the benefits of signing an agreement to give the BCH unrestricted access to a pool of government securities to implement monetary policy—as is successfully done in other countries.



Sources: Central Bank of Honduras and Haver Analytics

**40. The authorities aim at improving the monetary policy operational framework through better governance at the central bank.** They plan to submit to Congress a new BCH charter by

[10] The "law of financial support for the productive sectors" mandated the BCH to place 5 billion lempiras in a trust to finance housing. In 2009 its size was increased to 10 billion Lempiras; and again in 2013 to 13 billion lempiras.

December 2019, supported by continued technical assistance from the Fund to strengthen the central bank's capacity required to implement this reform. The charter will aim at safeguarding operational autonomy and at increasing transparency and accountability of the institution by, *inter alia*, stating price stability as the policy mandate of the BCH, improving transparency through the international financial reporting standards, securing a sound governance structure, including by clarifying operational, oversight, and decision-making responsibilities.

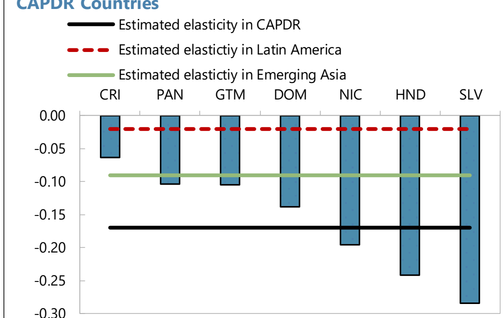
**41. A gradual transition toward a more flexible exchange rate regime will be instrumental to buffer external shocks.** Modernizing the monetary policy regime will allow Honduras to buffer external shocks more effectively. However, risks from balance sheet vulnerabilities and a high exchange rate pass through call for a gradual and cautious approach (Box 3). Thus far, the authorities have reduced FX surrender requirements by 30 percent; and they are committed to work on a plan to phase out the remaining 70 percent of foreign exchange surrender requirements.

## Box 3. The Buffering Role of Exchange Rate Flexibility

**The experience in Latin America suggests that exchange rate flexibility can buffer external shocks, reducing their impact on international reserves and domestic demand.** The May 2017 Regional Economic Outlook looked at the impact of external shocks in two groups of countries in Latin America: LA5 countries (Brazil, Chile, Colombia, Mexico, and Peru); and commodity exporters with less flexible exchange regimes (Argentina, Bolivia, Ecuador, Venezuela). It showed that countries with more exchange rate flexibility tend to lose fewer international reserves and experience milder compressions in domestic demand and imports following negative terms of trade shocks; in part due to a stronger export recovery and import substitution triggered by exchange rate depreciation—i.e., expenditure switching effects—that reduces the sacrifice ratio of falling domestic demand.

**Empirical evidence suggests that Honduras could benefit from exchange rate flexibility.** The high sensitivity of exports to the real exchange rate (REER) in CAPDR countries—larger than in the rest of Latin America, and even Emerging Asia—suggests that the export side of the expenditure switching channel can be instrumental in buffering real external shocks (see Honduras—Selected Analytical Issues, 2019). This result reflects the larger role played by textiles in the regional export basket. These benefits, though, should be weighed against risks from balance sheet vulnerabilities and a high exchange rate pass through, which call for caution and a gradual approach to more flexibility.

**Trade-Imputed Elasticity of Export Market Shares for CAPDR Countries**




Sources: United Nations Commodity Trade Statistics Database (Comtrade); IMF Information Notice System database; and IMF staff calculations.

**42. As part of the transition to inflation-targeting, work to improve prices and economic activity statistics will continue.** This is critical to assess the monetary stance. The authorities project to complete the National Household Income and Expenditure Survey (NHIES) by end-2021. They are also rebasing the national accounts to 2016, aiming at publishing the new series by December 2021.

**43. Honduras has eliminated one multiple currency practice subject to Fund jurisdiction.** The authorities have amended the rules applicable to the foreign exchange auction to eliminate the possibility of a spread of more than two percent between bids at which FX is sold within the auction. However, an additional MCP arises from the use of previous days' official exchange rates (TCR) in certain FX transactions, which rates may differ by more than two percent from the TCR in force and the interbank market rate on a given day. The authorities have requested temporary Fund approval of this measure, as well as the existing MCP arising from the lack of a mechanism to prevent a spread higher than 2 percent between the official exchange rates and the exchange rates resulting from the central bank FX auction, both of which are maintained for non-balance of payments reasons.[11] Staff supports this request as it does not materially impede Honduras's balance of payments adjustment, do not harm the interests of other members, and do not discriminate between Fund members. Staff note that the authorities' planned FX market liberalization should ultimately eliminate these measures.

### Resilience in the Financial Sector

**44. Stress tests show that the banking system is broadly resilient to most standardized shocks (Table 9).** They suggest that the overall banking sector is resilient to singular credit, interest rate, FX, and liquidity shocks. Capital adequacy would fall below the regulatory minimum of 10 percent only under a severe tail-risk combined shock.

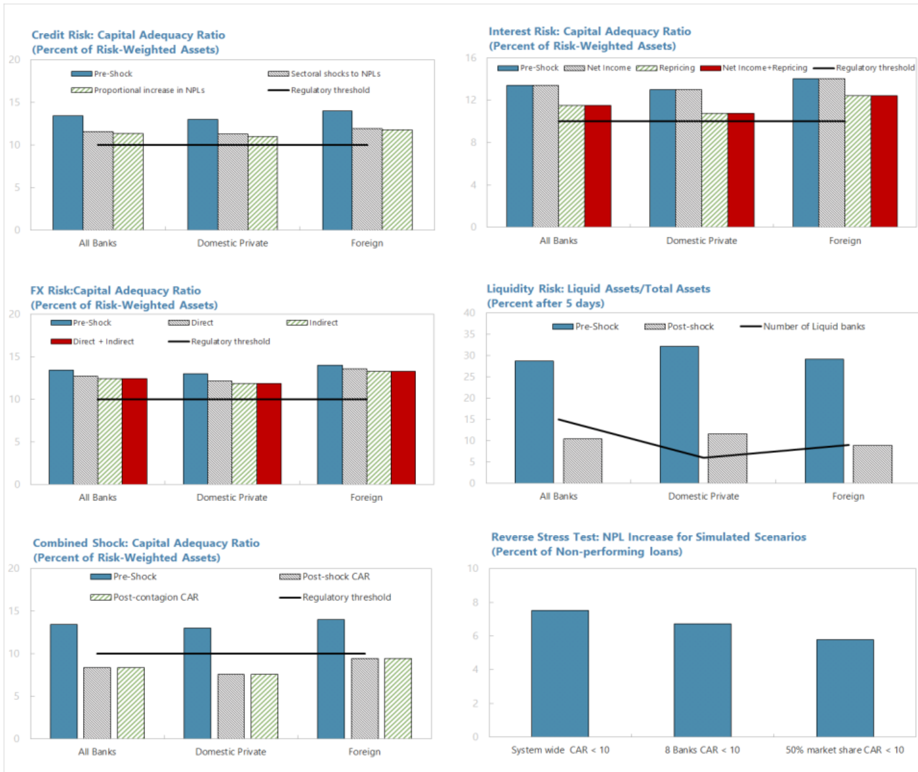
**45. The authorities' program envisages a close monitoring of the financial system.** Given stable but still high dollarization—and the fact that around ⅔ of FX credit is allocated to unhedged borrowers—the financial system warrants close monitoring. Albeit lower than in 2018, FX credit growth remained high in early 2019. While the authorities expect the growth in private FX credit to slow going forward—notably, due to the conclusion of strategic projects using dollar funding—they are alert to these risks; and stand ready to revisit their macroprudential framework if needed.

**46. The authorities are committed to resolve the financial situation of BANADESA.** BANADESA is an agricultural development bank under severe financial stress—its CAR is negative and NPLs reached 70 percent. With asset representing about one percent of GDP and very modest relationships with the rest of the banking system, BANADESA does not pose a systemic risk.[12] In January 2019, the Banking Commission (CNBS) issued orders to seize its administrative and operational control to protect depositors and operations. Given that measures on financial entities created by law cannot taken through administrative decisions, the authorities will follow the procedure envisaged in the financial sector law, which requires the CNBS to send a report to Congress, including a proposal to address the financial situation of the bank by September 2019.

[11] The authorities noted that spreads higher than 2 percent between the different exchange rates prevailing in the FX market never materialized since the peg was introduced in 2011.

[12] Assets of the private banking system are about 100 percent of GDP (Table 9).

## Figure 1. Stress Test Results




Sources: Country Authorities and IMF staff estimates.

Notes: The sample includes a total of 15 banks, of which 6 domestic owned and 9 foreign owned. *The System-Wide Credit Ris*k Shock assumes 4.7 percent (3 s.d. over average NPLs during the last decade, or about ⅓ of the impact of Hurricane Mitch in 1998) of outstanding performing loans to become non-performing; and the *Sectoral Shock* assumes increases in banks' NPLs in the housing, trade, services, consumption, industries, and agriculture sectors (which altogether account for about 80 percent of total loans) by 6.8, 4.7, 3.4, 6.1, 1.9, and 11.7 percent respectively (3 s.d. over average sectoral NPLs during the last 10 years). The *Interest Rat*e Shock assumes a 3.3 percentage points nominal interest rate increase. The *FX Shock* assumes a 10 percent depreciation of the FX rate, leading to 5 percent of FX loans becoming NPL. The *Liquidity Shock* assumes a 10 and 8 percent per day withdrawal of demand deposits in domestic and foreign currency respectively; and a 5 and 3 percent per day withdrawal of time deposits in domestic and foreign currency respectively.

47. **The authorities will continue to assess the investment policy framework of public pension funds.** Due to Honduras' demographic profile and recent increases in contribution rates, liquidity in public pension funds is high and investment opportunities are scarce. As a result, pension funds are granting consumer loans to affiliates, which have a high return. While the reduction by the CNBS of the regulatory ceiling on the share of these loans—from 50 to 40 percent of the portfolio—has contributed to a slower pace of new lending, its share is still high at close to 30 percent. The authorities intend to move the investment policy framework towards international best practices gradually; and assess whether lending policies place the incentives to secure the right amount of accumulated rights—net of outstanding loans—at the time of retirement.

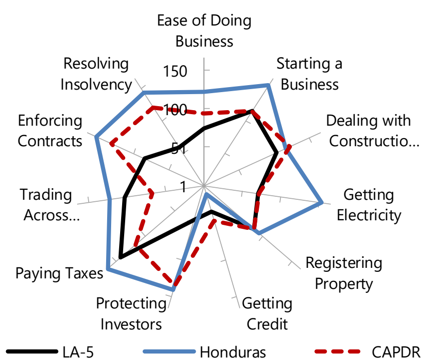
48. **Further efforts to address outstanding FSSR recommendations would enhance financial resilience** (Annex IV). The authorities have made significant progress to implement FSSR recommendations and adopt Basel III standards, including by developing the supervisory manual, starting a pilot program for risk-based supervision, and developing a methodology to identify

systemically important banks (with implementation pending). In line with the FSSR recommendations and the Basel III standard, the authorities' plan seeks to: (i) strengthen the capacity for risk-based supervision; (ii) keep developing stress testing capacities; (iii) establish a timeframe for the introduction of an additional capital charge for systemic banks; (iv) introduce regulations for market risks and develop new methodologies to assess operational risks. The CNBS will continue strengthening the AML/CFT framework—in line with recommendations from GAFILAT—and building the capacity of the superintendency of cooperatives (CONSUCOOP) to reinforce the AML/CFT compliance in this sector.

## E. Fostering Inclusive Growth: Social Spending, Anti-Corruption Efforts and the Business Climate

**49. The authorities are convinced that institutional reforms to improve governance and social spending can foster inclusive growth.** Discussions highlighted that economic growth and efforts to reduce inequality are conducive to less political polarization and a more favorable environment for reforms. This points to the need to enhance governance to improve the business environment and foster private investment and employment creation. Doing Business Indicators suggest that there is scope to improve contract enforcement and the protection of minority investors, as well as to reduce red tape and the cost of complying with business regulations, which increase vulnerabilities to corruption. Improving governance is also critical for inclusive growth, as it can prevent the misuse of public funds that can be allocated to protecting social expenditure.

**Doing Business Ranking, 2019**




Source: Doing Business 2019, and IMF staff calculations.

**50. The authorities' plan includes reforms to improve the business climate, through:**

- *A policy to simplify administrative procedures in the public sector.* The authorities plan to adopt legislation requiring regulatory agencies to streamline and publish requirements for obtaining permits, reducing discretion and the time needed for approval. Mapping all these procedures into a central repository—as part of the open government initiative—will increase transparency and provide a valuable analytical tool for their gradual rationalization. To improve transparency in rule making, agencies will be encouraged to develop forward looking regulatory plans and consult with the public on proposed new regulations.

- *The use of information technology to reduce transaction costs.* Various donor projects support this initiative, including in the areas of public procurement—where increased information about suppliers and greater integration with financial information systems will improve payment controls of public contracts—budget and personnel management, and automation of administrative procedures. The authorities are planning to implement the electronic signature as part of this process.

**51. The authorities are committed to develop an action plan to build on recent progress on rule of law and AML/CFT issues and to strengthen anticorruption efforts more broadly.** They have implemented recommendations embedded in the Financial Action Task Force of Latin America (GAFILAT) Report, notably by: (i) developing a national AML/CFT strategy—with technical support from the Inter-American Development Bank; (ii) strengthening the Financial Intelligence Unit and implementing a new electronic system for reporting of suspicious transactions; (iii) creating a new special unit for supervision of Designated Non-Financial Businesses and Professions (DNFBPs); and (iv) proposing legislation and cooperation at the regional level to ensure identification of companies' beneficial owners. They are committed to continue strengthening the AML/CFT framework in line with GAFILAT's recommendations—including continued incorporation of DNFPBs under the supervisory framework and further progress on identification of beneficial owners of incorporated companies. Building on this progress, the authorities are also working with IMF staff in an assessment of governance challenges to develop an action plan to strengthen governance and bolster anti-corruption initiatives, with a view of discussing it at the time of the first review. As discussed earlier, other reforms to enhance fiscal and central bank institutional frameworks will reduce governance vulnerabilities as well.

**52. To make growth more inclusive, the authorities are committed to further expanding the social safety net.** The program defines priority social spending that will be protected going forward to develop public interventions that alleviate poverty in the short run and encourage households to invest in human capital. The program articulates these initiatives around the conditional cash transfer programs (CCTs)—there is evidence of the benefits associated with CCTs.[13] They aim at improving conditions at early childhood—through better nutrition and health—and at providing educational services to school-age children, which should facilitate the achievement of better educational outcomes. The authorities' target is to cover all population in extreme poverty by end-2021.

**Priority Social Spending**

Social Safety Net
- *Better families*
- *School lunch*
- *Teen pregnancy prevention program*
- *Criando con amor*
- *Conditional Cash Transfer*
- *Other "Vida Mejor" interventions*

Early childhood
Childcare
Support for people with disabilities
Ciudad Mujer
Strengthening pre-elementary education
Maternal and Newborn Health Integration
Assistance to vulnerable women/children
Opportunities for young mothers
Assistance to people with special abilities
Women empowerment through credit
Electricity subsidy for low-income consumers

**53. The program has also identified priority interventions that are expected to enhance gender equality, supporting women entrepreneurship and participation in labor markets.** Although low participation of women in the labor market is a regional phenomenon, Honduras is below other Latin American countries. While progress has been made over the last 10 years, the gender gap is still large—the female labor participation rate reached 46 percent in 2018, compared to 76 percent for males. The authorities' strategy combines new programs with ongoing initiatives to improve opportunities for women by: (i) supporting childcare services; (ii) facilitating credit for women; (iii) supporting women with young children.

[13] See Molina-Millan and others (2019) "The Long-Term Impacts of Honduras' CCT Program: Higher Education and International Migration". IDB Working Papers Series No. 907.

Ongoing programs will be either maintained or expanded, including: (i) C*iudad Mujer*, which offers integral support for women, including by promoting entrepreneurship; (ii) teen pregnancy prevention, which increases opportunities for women to access education and enter labor markets; and (iii) opportunities for young mothers. These programs are coupled with family support initiatives, such as '*Criando con Amor*' and '*Mejores Familias*'.

**54. Assistance to migrants is also important in the social agenda.** Migration to the U.S. has increased significantly during the past 20 years—it is estimated that about 7 percent of the Honduran population lives in the United States. In recent years, the increase in the number of Hondurans living in the U.S. has remained stable, while the number of apprehensions in the U.S. and the Mexican borders has increased markedly—particularly in 2018, likely associated with the migrant caravans. To respond to the challenge of reducing emigration, the authorities have appointed a task force within the state department, the social development ministry, and the human rights ministry. Its mandate is to articulate a comprehensive effort to assist potential and returning migrants, which is going to complement the FOSMIH, an existing fund to support Honduran migrants.

# PROGRAM MODALITIES

**55. Program duration, conditionality, and reviews.** A 24-month Fund-supported program would provide an adequate framework to support the implementation of the measures envisaged in the program, including progress on the structural reform agenda. Program performance would be monitored by semi-annual reviews (see Tables 1 and 2 of Attachment I) with:

- *Prior actions,* to: (i) approve new tariff scheme that secures the recovery of electricity generation and ENEE's operational costs; (ii) prepare a plan to secure financial sustainability in ENEE, including a debt profile and policies for energy purchase that are consistent with the new tariff scheme; and (iii) present a plan to secure a reduction in electricity losses, starting in 2019.

- *Quantitative Performance Criteria,* setting: (i) a floor on the NFPS net lending; (ii) a floor on ENEE net lending; (iii) a ceiling on lending minus repayments from state-owned pension funds; (iv) non-accumulation of external payments arrears by the public sector; (v) a ceiling on the accumulation of domestic arrears by ENEE; (vi) a floor on the change in the stock of central bank's non-borrowed reserves; (vii) a ceiling in the stock of net domestic assets of the central bank (QPC).

- *Indicative Targets,* setting: (i) a floor on tax revenues collected by the budgetary central government; (ii) a ceiling on the budgetary central government wage bill; (iii) a floor on priority social spending of the budgetary central government; (iv) a floor on the reduction of losses by ENEE; (v) a floor on ENEE's operational ratio.

**56. Access and phasing.** With no immediate BOP needs, the authorities plan to treat the arrangements as precautionary. Staff proposes an access level of 90 percent of quota, or SDR 224.82 million, split between the SCF arrangement (SDR 74.94 million, 30 percent of quota) and the SBA arrangement (SDR 149.88, 60 percent of quota). This is justified by the external risks faced by the economy. While real growth performance has remained resilient in recent years, Honduras is an energy importer. Given global risks associated with large swings in energy prices (Annex III), a deterioration in terms of trade raises vulnerabilities to the current account (Annex VI).

**57. Capacity to Repay.** Although the authorities intend to treat the program as precautionary, Honduras has strong capacity to repay the Fund. It currently has no outstanding liabilities with the Fund. The proposed access would not affect significantly the level of external debt, and the DSA indicates that the risk of debt distress is low (Appendix II).

**58. Risks to the program stem from the current constellation of global risks and slippages in the implementation of reforms.** Global risks are particularly relevant for Honduras and may affect the outlook. The electricity sector reform requires coordinated and sequential actions, as well as collaboration from stakeholders that may have different interests. Some measures will require complex legal procedures, such as the unbundling of ENEE. Financial operations to improve the profile of ENEE's debt are also complex. On the revenue side, reforms to the tax code require legislative approval.

**59. Safeguards Assessment.** The safeguards assessment of the BCH will be conducted before the first program review. The most recent assessment—completed in April 2015—highlighted the need to revise the BCH's institutional framework to protect the bank from political interference, establish its financial autonomy, and strengthen its governance arrangements. It also found that the BCH would benefit from aligning its financial reporting practices with international standards. The program includes structural reforms to strengthen BCH's governance and accountability.

# STAFF APPRAISAL

**60. Over the last years, Honduras has made significant efforts to strengthen its policy framework.** In December 2017, Honduras completed a three-year IMF-supported program that managed to stabilize the economy and pave the way for sustainable medium-term growth. The program institutionalized fiscal prudence and introduced elements of a modern monetary policy framework, with a view to transition to inflation targeting in coming years. Supported by these ambitious reforms, the macroeconomic environment remained stable; and confidence improved—Honduras's debt spreads declined steadily and reflected into better financing terms for private and public investment. The external position is broadly in line with fundamentals and desirable policies.

**61. While progress has been remarkable, the country still faces significant challenges that hinder growth.** Honduras remains one of the poorest countries in the Western Hemisphere. Structural poverty is related to large informality, a strong dependence on agriculture and violence. Coupled with weak productive capacity, poverty and inequality remain Honduras's main medium-term growth impediments. Significant progress in the fight against violence over the last years has resulted in a sharp decline in violent crime, but the latter remains above the Latin-American average.

And the configuration of external risks—trade tension, migration policies, volatile terms of trade and tightening financial conditions—may affect the macroeconomic outlook.

**62. To face these challenges, the authorities' plan aims at maintaining macroeconomic stability while enacting economic and institutional reforms to foster inclusive growth.** Adherence to the FRL is planned to be coupled with bold reforms to resolve the structural challenges in the electricity sector and to place the finances of the electricity company on a sustainable path. These reforms will be aided by efforts to maintain previous revenue mobilization achievements, which help maintain space to reduce the infrastructure gap and increase social spending. The program will continue strengthening monetary policy and financial institutions; and developing money and foreign exchange markets to transition towards inflation targeting.

**63. The authorities are also fully committed to strengthening governance, including by stepping up efforts in their fight against corruption.** These governance reforms will tackle areas that pertain to the macroeconomic policy framework. In this connection, the authorities' plan aims at improving governance and transparency in public finance management, the monetary policy operational framework, and the electricity sector. The authorities are also working with the staff and other development partners to implement reforms aimed at enhancing the rule of law, which will prevent the misuse of public funds and improve the business climate—notably by simplifying procedures in public administration with the objective of reducing red tape and discretion, which can give rise to corruption. They are convinced that enhancing governance will foster private investment and employment creation.

**64. Finally, the authorities' program also strives to protect the poor and bolster gender equality.** The fiscal program defines priority spending that will be protected going forward; and comprises a set of high-impact interventions aimed at alleviating poverty and fostering investment in human capital, critical for long-term inclusive growth. In this context, protecting early childhood and reducing the gender gap is a priority for social spending—despite progress over the last 10 years, Honduras is below the regional average in the participation of women in labor markets. Hence, to unlock their potential in labor markets, the program has identified a set of priority interventions to support women entrepreneurship and participation in labor markets.

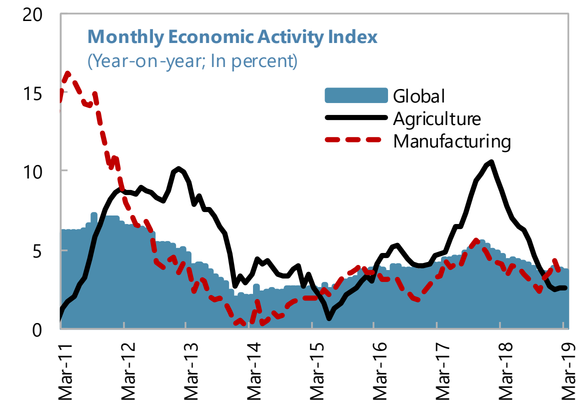
**65. Given the strength of the authorities' economic program, staff fully supports the request for SBA/SCF arrangements for SDR 224.8 million.** The government's economic plans are well-designed to maintain macroeconomic stability and reduce vulnerabilities to downside risks, protect society's most vulnerable, and support growth and job creation. These efforts merit the support of the international community.

**66. Staff supports the authorities' request for temporary approval of multiple currency practices subject to Fund jurisdiction under Article VIII, Section 3**.

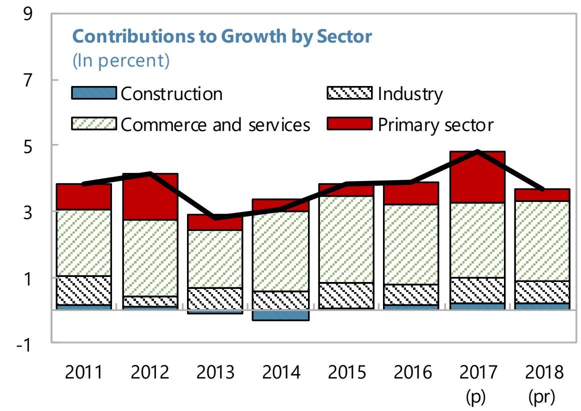
**67. It is recommended that the next Article IV consultation takes place on a 24-month cycle.**

## Figure 2. Honduras: Real Sector Developments

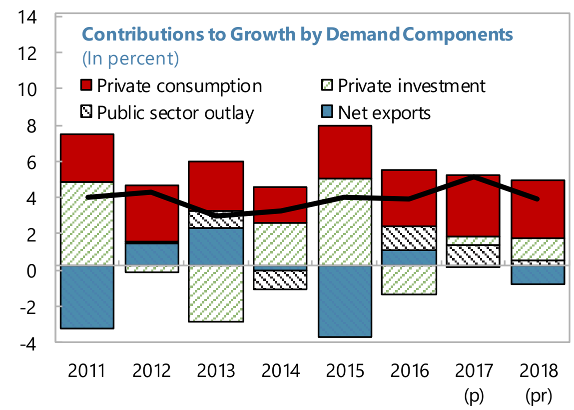
*Economic activity softened in 2018 ...*



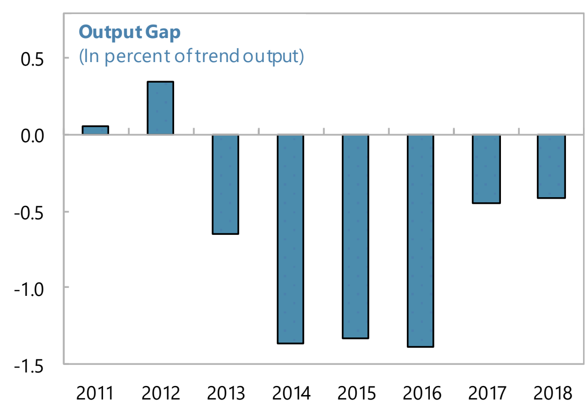

*... driven by adverse shocks in the primary sector...*



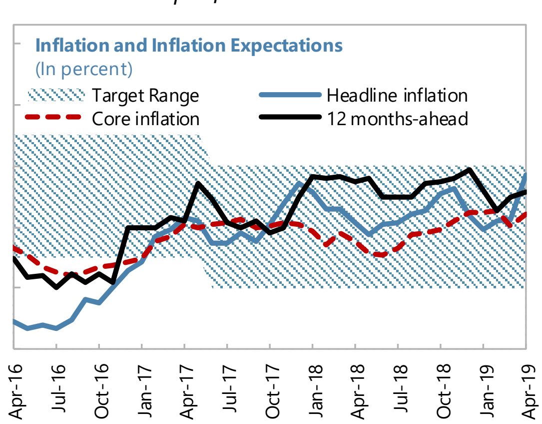

*... and lower public investment and exports.*



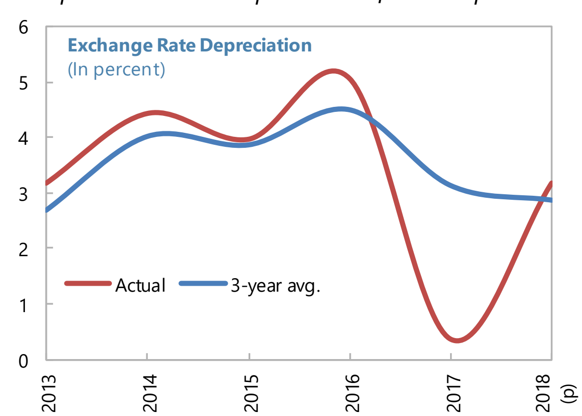

*A slightly negative output gap ...*




*... contributed to keep inflation stable...*

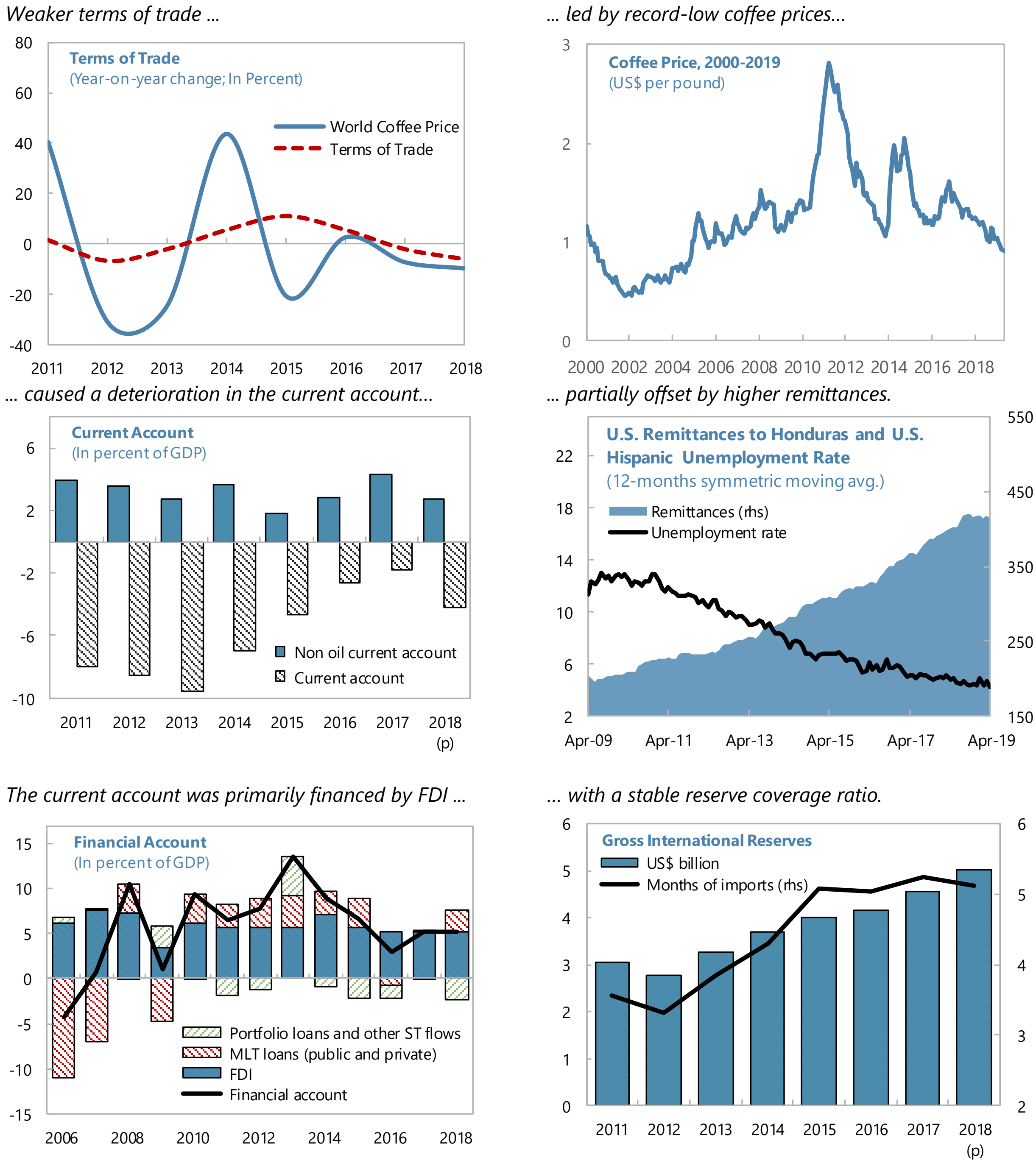



*... despite a moderate depreciation of the Lempira.*




Sources: Central Bank of Honduras and IMF staff estimates and projections.

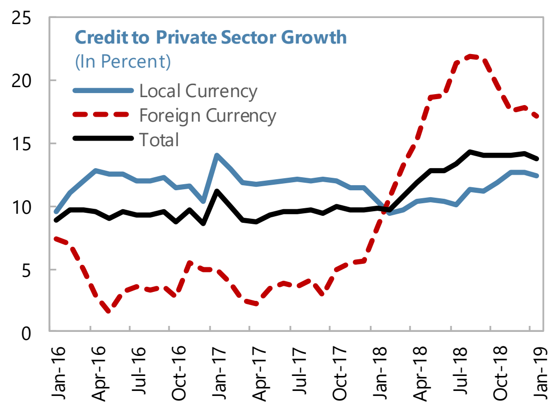
## Figure 3. Honduras: External Sector Developments



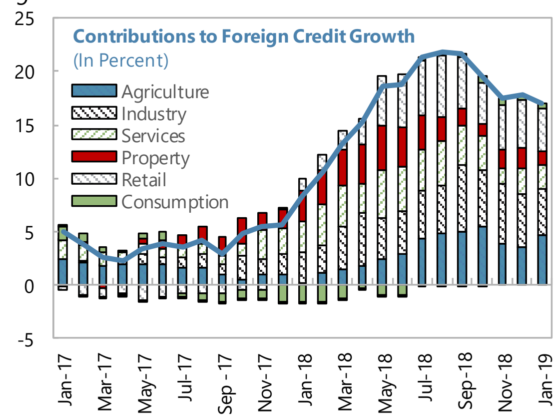

Sources: Central Bank of Honduras, Bloomberg, Haver Analytics, and IMF staff estimates and projections.

## Figure 4. Honduras: Financial Sector Developments

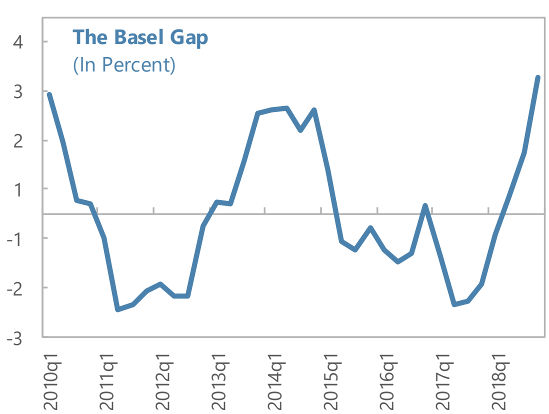
*Credit growth increased sharply, particularly in FX.*



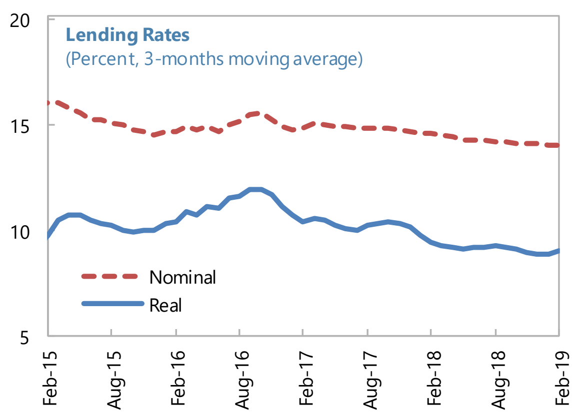

*FX credit was mainly for industry, retail, and agriculture …*



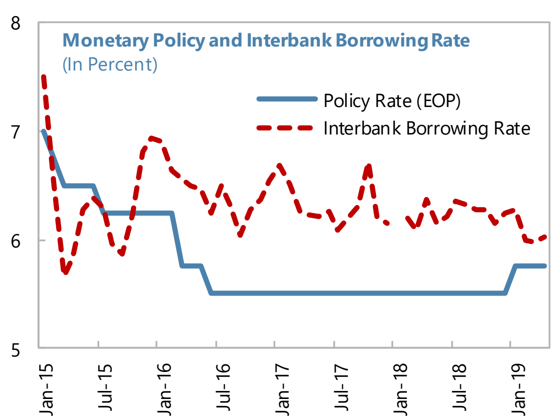

*… and has turned the credit gap positive.*



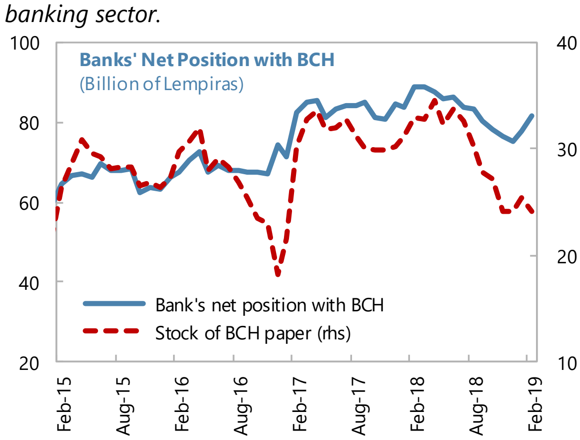

*Nominal lending rates have stabilized.*




*The interbank rate has remained stable …*



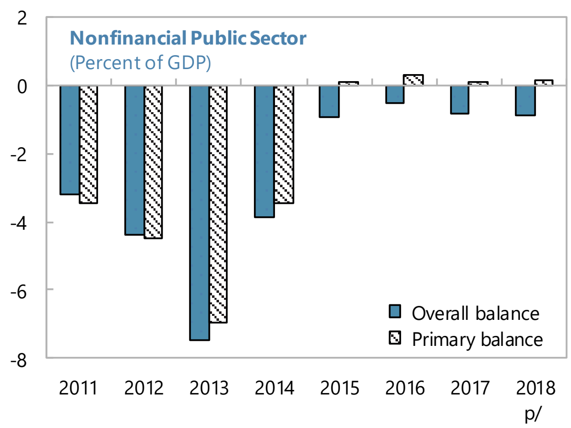

*… in the context of higher central bank credit to the banking sector.*



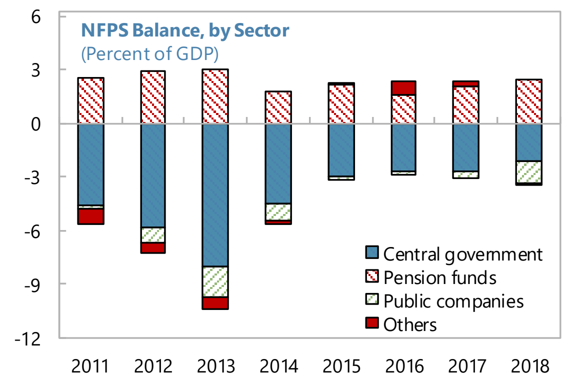

Sources: Central Bank of Honduras and IMF staff estimates and projections.

## Figure 5. Honduras: Public Finances

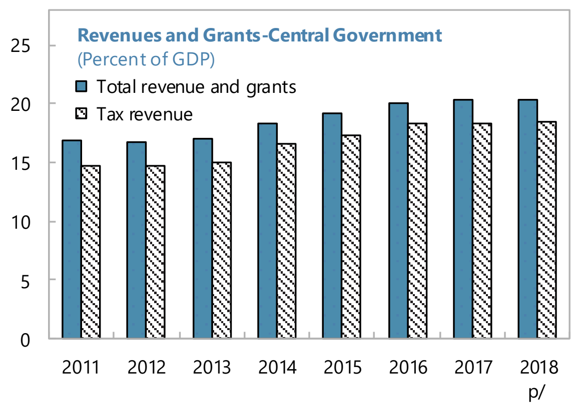
*The NFPS deficit remained below the FRL ceiling …*



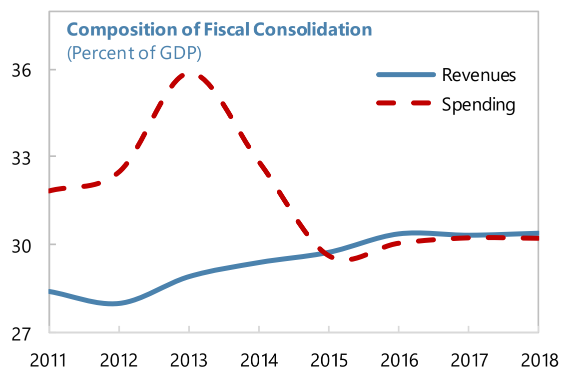

*… despite a large increase in the deficit of ENEE.*



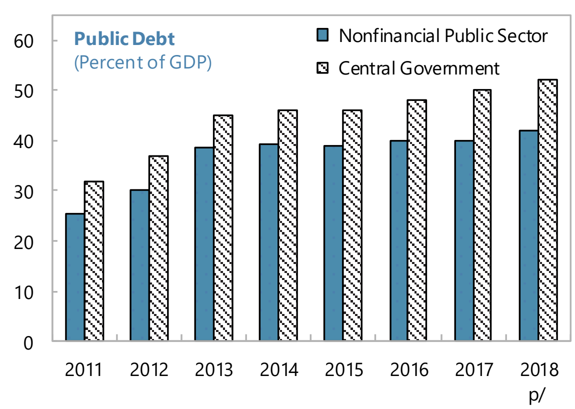

*Tax collection remained robust …*



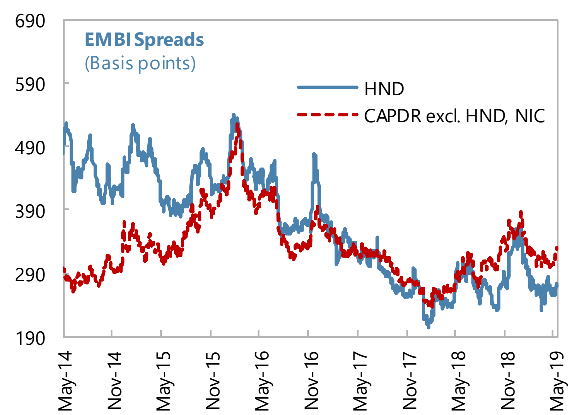

*… and primary spending stable.*




*Since 2014, public debt has stabilized …*



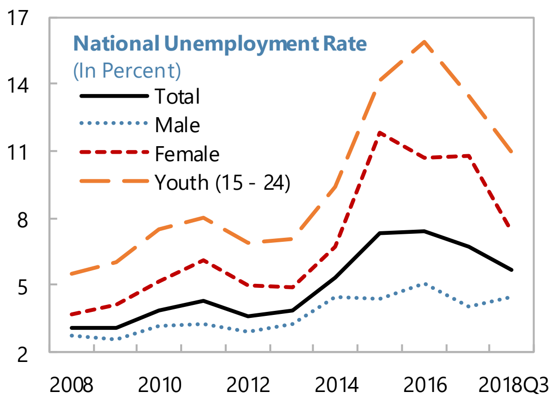

*… contributing to reduce debt spreads.*



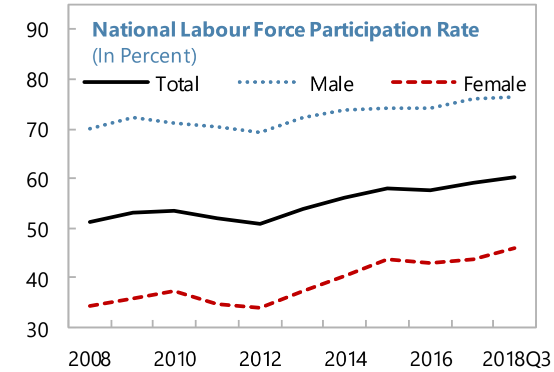

Sources: Ministry of Finance and IMF staff estimates and projections.

## Figure 6. Honduras: Labor Market Developments

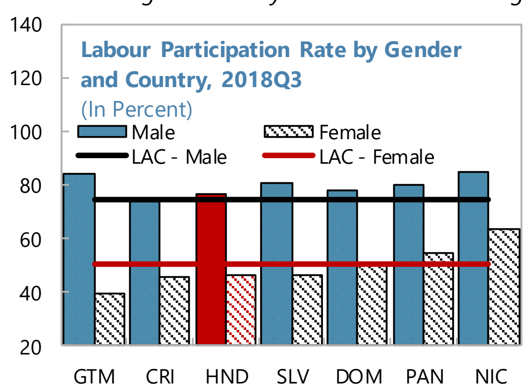
*Unemployment rates have declined.*



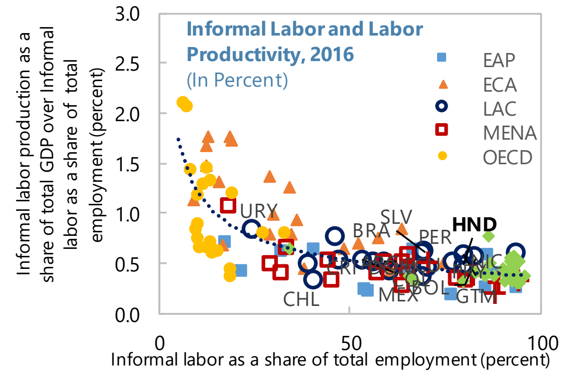

*Labor force participation rates have also been rising steadily and the gender gap has fallen.*



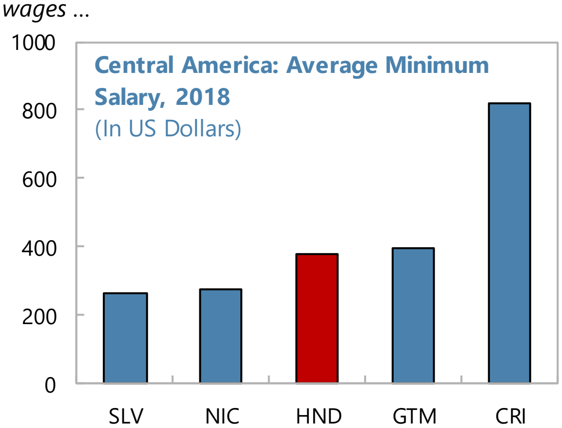

*However, female labor participation remains one of the lowest in the region and stays below the LAC average.*



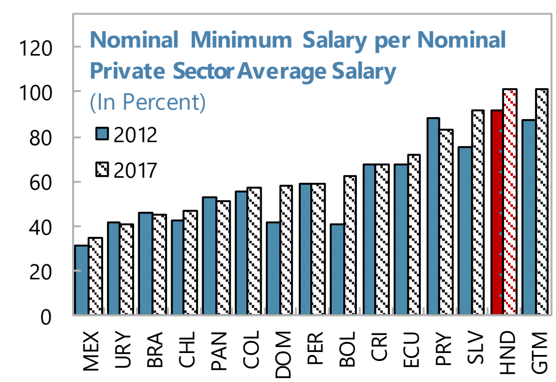

*Informality is one the largest in LAC, dragging on productivity and competitiveness.*




*It is in part explained by relatively high minimum wages …*



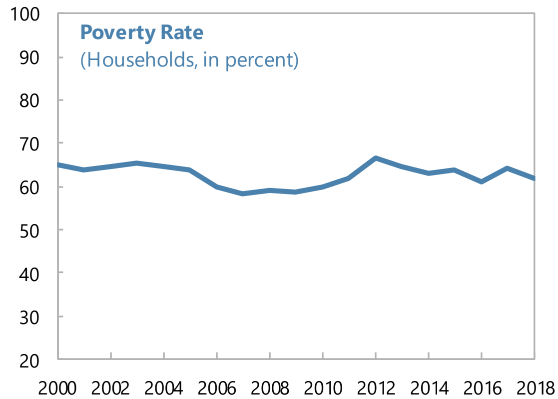

*… that are not in line with labor market conditions.*



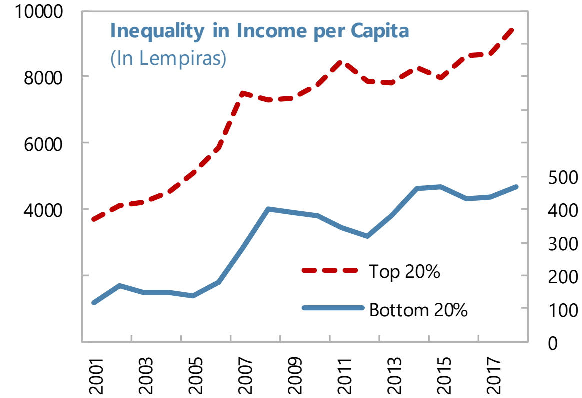

Sources: International Labour Organization; Panorama Laboral América Latina y el Caribe (2018), Ministry of Labor, and IMF staff calculations.

## Figure 7. Honduras: Social Conditions

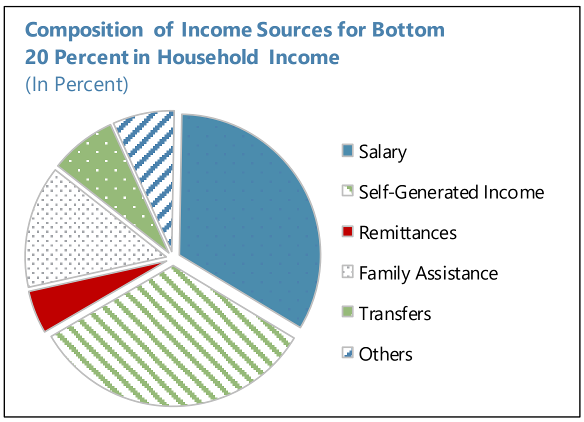
*The income measure of poverty has been stable at about 60 percent of households for more than 20 years …*



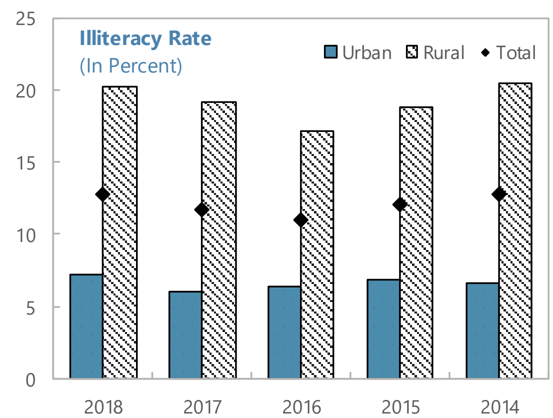

*… and income inequality has increased.*



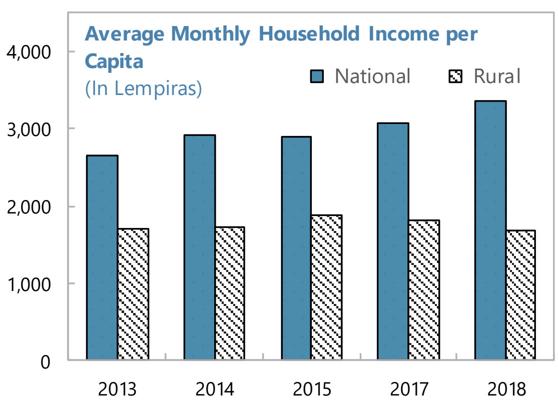

*Transfers are an important component of poor households' income.*



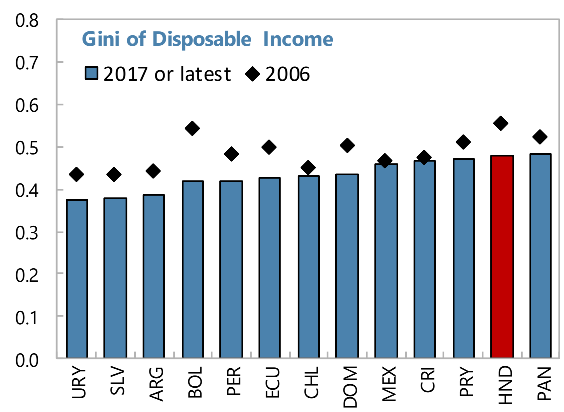

*Illiteracy rates are high, particularly in rural areas.*




*Rural incomes continue to be largely below urban income …*




*… and the Gini index remains high.*




Sources: International Labour Organization; Panorama Laboral América Latina y el Caribe (2018); Informality: Why Is It So Widespread and How Can It Be Reduced?, Loayza (2018); Honduras' National Institute of Statistics (INE); OECD Income Distribution database; and IMF staff calculations.

# Table 1. Honduras: Selected Economic Indicators

## I. Social Indicators

| | | | |
|---|---|---|---|
| Population (2017) | | Life expectancy at birth in years (2015) | 73 |
| Per capita income in U.S. dollars (PPP, 2017) | | Adult literacy (percent of ages 15 and above, 2014) | 89 |
| Rank in UNDP Development Index (2018) | | Percent of pop. below poverty line (2018) | 61.9 |
| Unemployment rate (2017) | | Gini index (2018) | 53 |
| Underemployment rate (2016) | | Oil imports (2018) | U.S. $1.7 billion |
| Net FDI (as percent of GDP, 2018) | | Main exports: coffee, bananas, palm oil, and maquila. | |

## II. Economic Indicators

| | | | | Prel. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| **Real Sector (percentage changes in contributions to growth)** | | | | | | | | | | |
| **Real GDP** | **3.8** | **3.8** | **4.9** | **3.7** | **3.4** | **3.5** | **3.6** | **3.7** | **3.9** | **3.9** |
| Domestic demand | 7.7 | 2.8 | 5.0 | 4.8 | 4.2 | 4.6 | 4.6 | 4.8 | 5.0 | 5.2 |
| Consumption | 3.2 | 3.8 | 3.5 | 3.5 | 3.3 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| Private | 2.9 | 3.1 | 3.3 | 3.2 | 3.1 | 3.2 | 3.2 | 3.2 | 3.2 | 3.1 |
| Public | 0.3 | 0.7 | 0.2 | 0.3 | 0.2 | 0.6 | 0.6 | 0.6 | 0.6 | 0.7 |
| Investment | 2.5 | -1.5 | 1.7 | 1.1 | 0.7 | 1.4 | 1.6 | 1.2 | 1.6 | 1.7 |
| Private | 2.8 | -2.1 | 0.7 | 1.1 | 0.9 | 1.1 | 1.1 | 1.1 | 1.3 | 1.4 |
| Public | -0.2 | 0.6 | 1.0 | 0.0 | -0.2 | 0.4 | 0.5 | 0.1 | 0.3 | 0.3 |
| Net exports | -3.9 | 0.9 | -0.1 | -1.0 | -0.8 | -1.0 | -1.0 | -1.0 | -1.1 | -1.3 |
| Exports | 1.7 | 0.2 | 3.2 | 0.8 | 1.9 | 2.9 | 2.7 | 3.1 | 3.2 | 3.2 |
| Imports | 5.6 | -0.7 | 3.2 | 1.8 | 2.8 | 3.9 | 3.7 | 4.1 | 4.3 | 4.5 |
| **Prices (annual percentage change)** | | | | | | | | | | |
| GDP deflator | 6.9 | 3.8 | 4.3 | 1.8 | 3.2 | 3.4 | 3.2 | 3.5 | 3.6 | 3.7 |
| Consumer prices (eop) | 2.4 | 3.3 | 4.7 | 4.2 | 4.4 | 4.2 | 4.0 | 4.0 | 4.0 | 4.0 |
| Consumer prices (average) | 3.2 | 2.7 | 3.9 | 4.3 | 4.4 | 4.2 | 4.0 | 4.0 | 4.0 | 4.0 |
| **Saving and Investment (percent of GDP)** | | | | | | | | | | |
| **Gross domestic investment** | **26.4** | **23.4** | **24.3** | **25.7** | **25.7** | **26.9** | **27.5** | **27.7** | **28.3** | **29.0** |
| Private sector | 22.6 | 20.2 | 19.9 | 21.3 | 21.7 | 22.6 | 22.8 | 23.1 | 23.5 | 24.1 |
| Public sector | 3.8 | 3.2 | 4.4 | 4.4 | 4.0 | 4.3 | 4.7 | 4.6 | 4.8 | 4.9 |
| **Gross national savings** | **21.7** | **20.8** | **22.6** | **21.5** | **21.5** | **22.6** | **23.3** | **23.6** | **24.4** | **25.1** |
| Private sector | 19.0 | 18.1 | 18.9 | 17.9 | 18.8 | 19.6 | 19.7 | 20.0 | 20.3 | 20.8 |
| Public sector | 2.8 | 2.6 | 3.5 | 3.3 | 3.0 | 3.4 | 3.8 | 3.7 | 3.9 | 4.0 |
| **Nonfinancial public sector (percent of GDP)** | | | | | | | | | | |
| Primary balance | 0.1 | 0.3 | 0.1 | 0.0 | 0.6 | 0.7 | 0.8 | 1.0 | 0.9 | 0.9 |
| Overall balance | -0.9 | -0.5 | -0.8 | -0.9 | -0.9 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 |
| Gross debt | 39.0 | 39.9 | 39.9 | 41.8 | 42.1 | 42.0 | 41.9 | 41.4 | 40.9 | 39.9 |
| **Balance of payments** | | | | | | | | | | |
| External current account balance (percent of GDP) | -4.7 | -2.6 | -1.8 | -4.2 | -4.2 | -4.3 | -4.2 | -4.1 | -3.9 | -3.9 |
| Exports, f.o.b. (annual percentage change) | 1.3 | -3.2 | 8.6 | 0.3 | -0.4 | 3.1 | 4.3 | 4.8 | 4.5 | 4.6 |
| Imports, f.o.b. (annual percentage change) | 0.8 | -5.5 | 7.2 | 7.7 | 2.8 | 3.9 | 3.9 | 4.0 | 4.9 | 4.4 |
| Worker's Remittances (percent of GDP) | 17.4 | 17.7 | 18.6 | 20.0 | 20.9 | 20.7 | 20.4 | 20.2 | 19.8 | 19.4 |
| Net International Reserves (millions of dollars) | 3,822 | 3,888 | 4,786 | 4,853 | 4,994 | 5,162 | 5,378 | 5,685 | 6,041 | 6,433 |
| GIR (In months of imports) 1/ | 5.1 | 5.0 | 5.3 | 5.1 | 5.0 | 5.0 | 5.0 | 5.0 | 5.1 | 5.1 |
| M1 to Net International Reserves (ratio) | 1.6 | 1.6 | 1.7 | 1.7 | 1.7 | 1.6 | 1.6 | 1.6 | 1.7 | 1.7 |
| Terms of Trade (annual percent change) | 11.1 | 5.5 | -2.3 | -6.3 | 1.0 | 0.5 | 1.0 | 0.0 | -0.2 | -0.2 |
| Real effective exchange rate (eop, depreciation -) | 1.8 | -2.0 | -0.9 | 1.3 | … | … | … | … | … | … |
| **Money and Financial** | | | | | | | | | | |
| Broad money (percentage change) | 9.0 | 15.6 | 12.8 | 8.3 | 9.0 | 11.0 | 11.2 | 13.4 | 11.2 | 12.2 |
| Private sector credit (percentage change) | 10.0 | 12.9 | 9.4 | 13.4 | 11.6 | 9.0 | 8.1 | 7.9 | 7.8 | 7.2 |
| Bank Assets (percent of GDP) | 97.0 | 97.8 | 97.8 | 105.0 | 109.9 | 111.9 | 113.0 | 113.6 | 113.8 | 113.1 |
| Private Credit (percent of GDP) | 54.0 | 56.6 | 56.6 | 60.7 | 63.5 | 64.7 | 65.4 | 65.7 | 65.8 | 65.4 |
| Non-Performing Loans to total loans (ratio) | 3.0 | 2.9 | 2.8 | 2.6 | … | … | … | … | … | … |
| Capital Adequacy (percent) | 14.0 | 13.8 | 13.7 | 13.4 | … | … | … | … | … | … |

Sources: Central Bank of Honduras, Ministry of Finance, and IMF staff estimates and projections.
1/ Based on following year's imports of goods and services, excluding maquila.

## Table 2. Honduras: Statement of Operations of the Central Government

(In percent of GDP)

| | Act. | | Prel. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| **Revenue** | **20.0** | **20.3** | **20.4** | **20.2** | **20.5** | **20.5** | **20.6** | **20.6** | **20.6** |
| Taxes | 18.3 | 18.3 | 18.5 | 18.1 | 18.5 | 18.5 | 18.6 | 18.7 | 18.7 |
| Taxes on income | 6.0 | 6.2 | 6.3 | 5.9 | 6.2 | 6.2 | 6.3 | 6.4 | 6.4 |
| Taxes on property | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Taxes on goods and services | 11.0 | 10.8 | 10.8 | 10.9 | 11.0 | 11.0 | 11.0 | 11.0 | 11.0 |
| Taxes on foreign trade | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Other taxes | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Social contributions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Grants | 0.8 | 0.6 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Other revenue | 0.9 | 1.4 | 1.2 | 1.4 | 1.4 | 1.3 | 1.3 | 1.3 | 1.3 |
| **Expenditure** | **22.8** | **23.0** | **22.4** | **22.6** | **23.1** | **23.4** | **23.5** | **23.6** | **23.5** |
| **Expense** | **20.8** | **20.2** | **20.0** | **20.5** | **20.3** | **20.2** | **20.3** | **20.2** | **20.1** |
| Compensation of employees | 8.0 | 8.5 | 8.3 | 8.2 | 8.2 | 8.2 | 8.2 | 8.2 | 8.2 |
| Purchases of goods and services | 2.8 | 2.7 | 2.2 | 2.2 | 2.1 | 2.0 | 2.0 | 2.0 | 2.0 |
| Interest | 2.6 | 2.7 | 3.0 | 3.3 | 3.2 | 3.0 | 3.1 | 2.9 | 2.9 |
| Domestic | 1.7 | 1.7 | 1.9 | 2.1 | 2.1 | 2.1 | 2.0 | 1.9 | 2.0 |
| Foreign | 0.9 | 1.0 | 1.1 | 1.2 | 1.1 | 1.0 | 1.1 | 1.0 | 0.9 |
| Subsidies | 0.0 | 0.0 | 0.2 | 0.3 | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| Grants | 3.7 | 2.6 | 2.5 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Current | 2.4 | 1.5 | 1.6 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Capital | 1.3 | 1.0 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Social benefits | 1.6 | 1.9 | 1.6 | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 2.5 |
| Other expense | 2.0 | 1.8 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Current | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Capital | 1.7 | 1.6 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| **Net acquisition of nonfinancial assets** | **2.0** | **2.8** | **2.4** | **2.0** | **2.8** | **3.2** | **3.2** | **3.4** | **3.4** |
| **Gross Operating Balance** | **-0.8** | **0.1** | **0.5** | **-0.4** | **0.2** | **0.3** | **0.3** | **0.5** | **0.5** |
| **Net lending (+)/borrowing (-)** | **-2.7** | **-2.7** | **-2.0** | **-2.4** | **-2.6** | **-2.9** | **-2.9** | **-2.9** | **-2.9** |
| **Net financial transactions** | **-2.7** | **-2.7** | **-2.0** | **-2.4** | **-2.6** | **-2.9** | **-2.9** | **-2.9** | **-2.9** |
| **Net acquisition of financial assets** | **-0.3** | **2.6** | **1.3** | **1.3** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| Foreign | 0.0 | 0.0 | 0.0 | 1.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Currency and deposits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.0 | 0.0 | 0.0 | 1.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other accounts receivable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic | -0.3 | 2.6 | 1.3 | -0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Currency and deposits | -0.3 | 2.6 | 1.3 | -0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other accounts receivable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Net incurrence of liabilities** | **2.5** | **5.3** | **3.3** | **3.7** | **2.6** | **2.9** | **2.9** | **2.9** | **2.9** |
| Foreign | 0.7 | 3.6 | 0.9 | 2.5 | 1.0 | 0.6 | 0.7 | 0.7 | 0.9 |
| Currency and deposits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.7 | 3.7 | 0.9 | 2.5 | 1.1 | 0.6 | 0.7 | 0.8 | 0.9 |
| Disbursment | 1.5 | 4.8 | 1.9 | 5.6 | 2.0 | 1.6 | 3.5 | 1.8 | 1.9 |
| Amorizations | -0.8 | -1.1 | -1.0 | -3.1 | -0.9 | -1.0 | -2.9 | -1.0 | -1.0 |
| Other accounts payable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exceptional financing 1/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other external | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic | 1.7 | 1.6 | 2.4 | 1.2 | 1.5 | 2.3 | 2.3 | 2.2 | 2.0 |
| Currency and deposits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 3.0 | 1.2 | 2.1 | 1.0 | 1.3 | 2.6 | 2.0 | 2.0 | 1.9 |
| Other accounts payable | -1.3 | 0.3 | 0.1 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| PPPs/other | 0.4 | 0.5 | 0.6 | 0.7 | 0.6 | 0.1 | 0.6 | 0.5 | 0.4 |
| Adjustment for HIPC debt relief 2/ | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.3 | -0.3 | -0.3 |
| **Memorandum items:** | | | | | | | | | |
| Net lending minus interest payments | -0.1 | 0.0 | 1.0 | 0.9 | 0.6 | 0.1 | 0.2 | 0.0 | 0.0 |
| Gross debt | 48.0 | 50.1 | 52.0 | 54.2 | 55.8 | 56.5 | 57.0 | 57.1 | 57.2 |
| *Excluding BCH recapitalization* | 44.3 | 45.7 | 46.7 | 49.3 | 50.9 | 52.3 | 52.7 | 52.7 | 52.8 |
| Nominal GDP (in billions of Lempiras) | 495.9 | 542.6 | 572.9 | 610.9 | 653.8 | 699.3 | 751.0 | 808.4 | 871.7 |

Sources: Honduran authorities, IMF staff estimates and projections.

1/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

2/ Offsets the HIPC/MDRI debt relief accounted as grants.

## Table 3. Honduras: Statement of Operations of the Nonfinancial Public Sector

(In percent of GDP)

| | Act. | | Prel. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| **Revenue** | **32.3** | **31.9** | **31.7** | **32.6** | **32.8** | **33.0** | **33.0** | **33.1** | **33.3** |
| Taxes | 19.4 | 18.7 | 18.9 | 18.6 | 18.9 | 19.0 | 19.0 | 19.1 | 19.2 |
| Taxes on income | 6.0 | 6.2 | 6.3 | 5.9 | 6.2 | 6.2 | 6.3 | 6.4 | 6.4 |
| Taxes on property | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Taxes on goods and services | 11.0 | 10.8 | 10.8 | 10.9 | 11.0 | 11.0 | 11.0 | 11.0 | 11.0 |
| Taxes on foreign trade | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Other taxes | 1.5 | 0.9 | 0.9 | 0.9 | 0.9 | 1.0 | 0.9 | 0.9 | 1.0 |
| Social contributions | 3.1 | 3.3 | 3.4 | 3.6 | 3.6 | 3.6 | 3.6 | 3.6 | 3.6 |
| Grants | 0.8 | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 |
| Other revenue | 9.0 | 9.3 | 8.7 | 9.8 | 9.6 | 9.7 | 9.7 | 9.8 | 9.9 |
| **Expenditure** | **32.8** | **32.7** | **32.7** | **33.5** | **33.7** | **33.8** | **33.8** | **33.9** | **34.1** |
| **Expense** | **29.6** | **28.2** | **28.3** | **29.5** | **29.4** | **29.1** | **29.2** | **29.2** | **29.2** |
| Compensation of employees | 11.3 | 11.2 | 11.3 | 11.2 | 11.3 | 11.1 | 11.1 | 11.1 | 11.1 |
| Purchases of goods and services | 8.1 | 8.3 | 8.2 | 8.3 | 8.1 | 8.1 | 8.1 | 8.2 | 8.3 |
| Interest | 2.7 | 2.4 | 2.6 | 3.2 | 3.0 | 2.9 | 3.0 | 2.9 | 2.9 |
| Domestic | 1.8 | 1.4 | 1.5 | 1.9 | 1.9 | 2.0 | 1.9 | 1.9 | 1.9 |
| Foreign | 1.0 | 1.0 | 1.2 | 1.3 | 1.1 | 1.0 | 1.1 | 1.0 | 0.9 |
| Subsidies | 0.0 | 0.0 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Social benefits | 3.6 | 4.1 | 3.7 | 4.3 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 |
| Other expense | 3.8 | 2.2 | 2.3 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.6 |
| Current | 1.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 |
| Capital | 2.7 | 1.8 | 2.0 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| **Net acquisition of nonfinancial assets** | **3.2** | **4.4** | **4.4** | **4.0** | **4.3** | **4.7** | **4.6** | **4.8** | **4.9** |
| **Gross Operating Balance** | **2.7** | **3.6** | **3.4** | **3.1** | **3.5** | **3.9** | **3.8** | **4.0** | **4.1** |
| **Net lending (+)/borrowing (-)** | **-0.5** | **-0.8** | **-0.9** | **-0.9** | **-0.8** | **-0.8** | **-0.8** | **-0.8** | **-0.8** |
| **Net financial transactions** | **-0.5** | **-0.8** | **-0.9** | **-0.9** | **-0.8** | **-0.8** | **-0.8** | **-0.8** | **-0.8** |
| **Net acquisition of financial assets** | **-0.4** | **0.4** | **2.5** | **0.5** | **0.5** | **0.6** | **0.2** | **0.6** | **0.1** |
| Foreign | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Currency and deposits | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other accounts receivable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic | -0.4 | 0.4 | 2.3 | 0.5 | 0.5 | 0.6 | 0.2 | 0.6 | 0.1 |
| Currency and deposits | -1.0 | 0.2 | 2.2 | 0.4 | 0.4 | 0.5 | 0.1 | 0.5 | 0.1 |
| Debt securities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.6 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Other accounts receivable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Net incurrence of liabilities** | **0.2** | **1.2** | **3.4** | **1.5** | **1.3** | **1.4** | **1.0** | **1.4** | **0.9** |
| Foreign | 1.0 | 3.8 | 1.1 | 2.6 | 1.0 | 0.7 | 0.7 | 0.7 | 0.9 |
| Currency and deposits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 1.0 | 3.8 | 1.1 | 2.6 | 1.1 | 0.7 | 0.7 | 0.8 | 0.9 |
| Other accounts payable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exceptional financing 1/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other external | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic | -0.5 | -2.2 | 2.7 | -0.7 | 0.6 | 1.1 | 0.7 | 1.0 | 0.3 |
| Currency and deposits | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans | 0.5 | -1.1 | 1.9 | -0.9 | 0.6 | 1.0 | 0.6 | 0.6 | -0.1 |
| Other accounts payable | -1.4 | -1.6 | 0.3 | -0.5 | -0.5 | 0.0 | -0.5 | -0.1 | 0.0 |
| PPPs/other | 0.4 | 0.5 | 0.6 | 0.7 | 0.6 | 0.1 | 0.6 | 0.5 | 0.4 |
| Adjustment for HIPC debt relief 2/ | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.3 | -0.3 | -0.3 |
| **Memorandum items:** | | | | | | | | | |
| Net lending minus net interest payments | 0.3 | 0.1 | 0.0 | 0.6 | 0.7 | 0.8 | 1.0 | 0.9 | 0.9 |
| Gross total debt | 39.9 | 39.9 | 41.8 | 42.1 | 42.0 | 41.9 | 41.4 | 40.9 | 39.9 |
| Nominal GDP (in billions of Lempiras) | 495.9 | 542.6 | 572.9 | 610.9 | 653.8 | 699.3 | 751.0 | 808.4 | 871.7 |

Sources: Honduran authorities, IMF staff estimates and projections.

1/ Includes debt forgiveness, accumulation, rescheduling, payment and/or forgiveness of arrears.

2/ Offsets the HIPC/MDRI debt relief accounted as grants.

## Table 4. Honduras: Summary Accounts of the Financial System

(In millions of Lempiras; end-December)

| | Act. | | Prel. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| | | | | | **I. Central Bank** | | | | |
| **Net International Reserves 1/** | **91,370** | **112,883** | **118,120** | **127,208** | **135,145** | **144,575** | **157,005** | **171,414** | **187,576** |
| (In millions of US$) | 3,888 | 4,786 | 4,853 | 4,994 | 5,162 | 5,378 | 5,685 | 6,041 | 6,433 |
| **Net Domestic Assets** | **-60,010** | **-75,317** | **-78,827** | **-85,253** | **-90,049** | **-95,991** | **-104,223** | **-113,875** | **-124,830** |
| Credit to the public sector (net) | 9,645 | 7,472 | -679 | 2,197 | 2,183 | 1,853 | 1,816 | 1,561 | 1,541 |
| Other depository institutions (net) | -74,216 | -84,589 | -75,207 | -83,151 | -89,463 | -96,198 | -104,467 | -113,734 | -123,391 |
| Other financial institutions | 10,277 | 8,302 | 6,919 | 6,516 | 6,061 | 5,578 | 5,029 | 4,420 | 3,748 |
| Nonfinancial private sector | -213 | -228 | -217 | -215 | -279 | -363 | -472 | -613 | -797 |
| Medium and long-term net foreign assets | 1,876 | 1,915 | 2,149 | 2,249 | 2,311 | 2,373 | 2,438 | 2,505 | 2,574 |
| Other items net | -7,361 | -7,923 | -11,792 | -12,850 | -10,862 | -9,235 | -8,568 | -8,014 | -8,505 |
| **Currency issued** | **31,359** | **37,567** | **39,292** | **41,955** | **45,096** | **48,584** | **52,782** | **57,539** | **62,746** |
| | | | | | **II. Other Depository Institutions** | | | | |
| **Net Foreign Assets** | **-14,740** | **-16,341** | **-24,768** | **-23,814** | **-23,818** | **-23,557** | **-23,070** | **-22,237** | **-20,958** |
| (In millions of US$) | -627 | -693 | -1,018 | -935 | -910 | -876 | -835 | -784 | -719 |
| Foreign assets (in million of US$) | 500 | 543 | 453 | 554 | 630 | 717 | 819 | 937 | 1,074 |
| **Net Domestic Assets** | **269,043** | **300,632** | **330,510** | **358,962** | **382,098** | **406,355** | **433,755** | **463,794** | **496,599** |
| Credit to the monetary authority (net) | 84,012 | 97,778 | 93,141 | 102,691 | 109,920 | 117,647 | 126,994 | 137,429 | 148,353 |
| Credit to other financial institutions (net) | -32,280 | -31,756 | -33,353 | -37,763 | -54,158 | -72,739 | -88,464 | -103,926 | -114,466 |
| Credit to the nonfinancial public sector (net) | -1,998 | -6,125 | -4,822 | -20,501 | -22,299 | -20,642 | -22,448 | -25,267 | -30,472 |
| Central government | -15,565 | -18,282 | -21,398 | -30,699 | -36,324 | -35,307 | -42,739 | -47,358 | -50,057 |
| Other nonfinancial public sector | 9,250 | 6,368 | 9,764 | 4,067 | 8,507 | 9,699 | 15,821 | 18,069 | 16,274 |
| Local governments | 4,317 | 5,789 | 6,812 | 6,131 | 5,518 | 4,966 | 4,470 | 4,023 | 3,620 |
| Credit to the private sector | 280,453 | 306,885 | 347,983 | 388,186 | 422,947 | 457,041 | 493,268 | 531,786 | 570,025 |
| Local currency | 205,788 | 228,136 | 255,046 | 286,781 | 314,412 | 340,944 | 369,505 | 400,105 | 430,258 |
| Foreign currency | 74,664 | 78,749 | 92,938 | 101,404 | 108,535 | 116,097 | 123,764 | 131,681 | 139,767 |
| Other items net | -61,143 | -66,149 | -72,440 | -73,650 | -74,313 | -74,951 | -75,595 | -76,228 | -76,842 |
| **Liabilities** | **254,348** | **284,278** | **305,786** | **335,148** | **358,280** | **382,798** | **410,685** | **441,557** | **475,641** |
| *Of which:* Deposits in domestic currency | 176,593 | 205,926 | 223,166 | 246,896 | 265,907 | 286,209 | 307,059 | 330,141 | 355,626 |
| *Of which:* Deposits in foreign currency | 72,425 | 78,352 | 82,049 | 90,096 | 96,314 | 102,905 | 110,402 | 118,701 | 127,864 |
| | | | | | **III. Financial System** | | | | |
| **Net Foreign Assets** | **78,182** | **98,580** | **95,940** | **105,975** | **114,106** | **124,039** | **137,279** | **152,901** | **170,777** |
| (In millions of US$) | 3,326 | 4,179 | 3,942 | 4,059 | 4,252 | 4,502 | 4,850 | 5,257 | 5,714 |
| **Net Domestic Assets** | **203,241** | **219,384** | **248,738** | **269,735** | **309,351** | **354,264** | **388,691** | **424,088** | **460,320** |
| Credit to the nonfinancial public sector | 7,974 | 1,167 | -5,417 | -18,111 | -19,904 | -18,591 | -20,414 | -23,456 | -28,625 |
| Credit to the private sector | 280,453 | 306,885 | 347,983 | 388,186 | 422,947 | 457,041 | 493,268 | 531,786 | 570,025 |
| Local currency | 205,788 | 228,136 | 255,046 | 286,781 | 314,412 | 340,944 | 369,505 | 400,105 | 430,258 |
| Foreign currency | 74,664 | 78,749 | 92,938 | 101,404 | 108,535 | 116,097 | 123,764 | 131,681 | 139,767 |
| Other items net 2/ | -80,998 | -69,417 | -80,731 | -84,978 | -87,618 | -90,286 | -93,151 | -96,255 | -99,657 |
| **Broad Money (M4)** | **281,747** | **317,841** | **344,239** | **375,187** | **416,525** | **463,308** | **525,238** | **584,252** | **655,428** |
| | | | | | (Rate of growth 12 months) | | | | |
| Currency issued | 6.5 | 19.8 | 4.6 | 6.8 | 7.5 | 7.7 | 8.6 | 9.0 | 9.0 |
| Currency in circulation | 11.4 | 18.7 | 3.4 | 6.2 | 7.2 | 7.5 | 8.7 | 9.2 | 9.3 |
| Broad money | 15.6 | 12.8 | 8.3 | 9.0 | 11.0 | 11.2 | 13.4 | 11.2 | 12.2 |
| Broad money (constant exchange rate) | 11.7 | 12.6 | 8.3 | 9.0 | 6.8 | 6.8 | 6.7 | 7.0 | 7.2 |
| Credit to the private sector | 12.9 | 9.4 | 13.4 | 11.6 | 9.0 | 8.1 | 7.9 | 7.8 | 7.2 |
| o/w foreign currency | 6.6 | 5.5 | 18.0 | 9.1 | 7.0 | 7.0 | 6.6 | 6.4 | 6.1 |
| Credit to the private sector (constant exchange rate) | 11.4 | 9.3 | 12.3 | 10.4 | 8.2 | 7.3 | 7.2 | 7.1 | 6.5 |
| M1 | 11.0 | 14.8 | 5.7 | 8.6 | 7.4 | 7.5 | 7.9 | 8.2 | 8.4 |

Sources: Central Bank of Honduras and IMF staff estimates and projections.

1/ Includes allocation of SDR 104.8 million in August, 2009.

2/ Includes the revaluation account reflecting changes in the value of assets due to exchange rate fluctuations.

## Table 5. Honduras: Balance of Payments

| | 2016 | 2017 | Prel. 2018 | Projections 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| | (In millions of U.S. dollars; unless otherwise indicated) | | | | | | | | |
| **Current account** | **-567** | **-409** | **-1,004** | **-1,030** | **-1,086** | **-1,108** | **-1,142** | **-1,113** | **-1,179** |
| Trade Account | -2,599 | -2,677 | -3,531 | -3,909 | -4,134 | -4,256 | -4,352 | -4,599 | -4,787 |
| Exports f.o.b. | 5,576 | 6,117 | 5,961 | 5,988 | 6,224 | 6,517 | 6,864 | 7,200 | 7,551 |
| Maquila (net) | 1,635 | 1,550 | 1,555 | 1,784 | 1,833 | 1,869 | 1,920 | 1,999 | 2,094 |
| Coffee | 913 | 1,317 | 1,115 | 841 | 930 | 1,048 | 1,101 | 1,178 | 1,237 |
| Others | 3,028 | 3,250 | 3,291 | 3,363 | 3,461 | 3,599 | 3,843 | 4,024 | 4,220 |
| Imports f.o.b. | -8,175 | -8,794 | -9,492 | -9,897 | -10,357 | -10,773 | -11,216 | -11,799 | -12,339 |
| Petroleum products | -1,171 | -1,403 | -1,658 | -1,566 | -1,603 | -1,627 | -1,659 | -1,705 | -1,757 |
| Others | -7,004 | -7,391 | -7,834 | -8,331 | -8,754 | -9,146 | -9,557 | -10,095 | -10,581 |
| Services (net) | -463 | -589 | -807 | -829 | -810 | -791 | -839 | -879 | -921 |
| *Of which:* tourism receipts | 693 | 715 | 736 | 758 | 785 | 817 | 855 | 896 | 940 |
| Income (net) | -1,508 | -1,636 | -1,600 | -1,640 | -1,693 | -1,756 | -1,836 | -1,791 | -1,821 |
| *Of which:* payments on direct investments | -1,278 | -1,392 | -1,410 | -1,388 | -1,437 | -1,496 | -1,554 | -1,629 | -1,709 |
| *Of which:* public sector interest payments | -182 | -212 | -237 | -299 | -276 | -282 | -306 | -291 | -288 |
| Transfers (net) | 4,003 | 4,493 | 4,934 | 5,348 | 5,551 | 5,695 | 5,885 | 6,155 | 6,350 |
| *Of which:* Remittances | 3,847 | 4,305 | 4,760 | 5,117 | 5,240 | 5,377 | 5,572 | 5,717 | 5,879 |
| Others | 155 | 188 | 174 | 231 | 311 | 319 | 313 | 438 | 471 |
| **Capital and Financial account** | **787** | **1,400** | **1,423** | **1,171** | **1,254** | **1,324** | **1,449** | **1,469** | **1,571** |
| **Financial account** | **657** | **1,220** | **1,255** | **994** | **1,070** | **1,133** | **1,249** | **1,260** | **1,352** |
| Direct investment (net) | 900 | 1,013 | 1,146 | 1,188 | 1,230 | 1,281 | 1,339 | 1,403 | 1,473 |
| Other private capital flows (net) | -395 | -582 | -155 | -834 | -400 | -330 | -278 | -360 | -155 |
| General government (net) | 152 | 789 | 264 | 639 | 240 | 182 | 187 | 216 | 34 |
| **Capital account** | **130** | **181** | **168** | **177** | **184** | **191** | **200** | **209** | **220** |
| Errors and omissions | -170 | -107 | -374 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Overall balance** | **50** | **885** | **46** | **141** | **168** | **216** | **307** | **356** | **392** |
| **Change in central bank reserves (- increase)** | **-66** | **-884** | **-50** | **-141** | **-168** | **-216** | **-307** | **-356** | **-392** |
| **Exceptional financing** | **16** | **-1** | **4** | **0** | **0** | **0** | **0** | **0** | **0** |
| | (In percent of GDP; unless otherwise indicated) | | | | | | | | |
| **Current account** | **-2.6** | **-1.8** | **-4.2** | **-4.2** | **-4.3** | **-4.2** | **-4.1** | **-3.9** | **-3.9** |
| Trade Account | -12.0 | -11.6 | -14.8 | -16.0 | -16.3 | -16.1 | -15.8 | -15.9 | -15.8 |
| Exports f.o.b. | 25.7 | 26.5 | 25.0 | 24.5 | 24.6 | 24.7 | 24.9 | 24.9 | 24.9 |
| Maquila net (exports-imports) | 7.5 | 6.7 | 6.5 | 7.3 | 7.2 | 7.1 | 7.0 | 6.9 | 6.9 |
| Coffee | 4.2 | 5.7 | 4.7 | 3.4 | 3.7 | 4.0 | 4.0 | 4.1 | 4.1 |
| Others | 13.9 | 14.1 | 13.8 | 13.8 | 13.7 | 13.7 | 13.9 | 13.9 | 13.9 |
| Imports f.o.b. | -37.6 | -38.1 | -39.9 | -40.5 | -40.9 | -40.9 | -40.7 | -40.9 | -40.7 |
| Petroleum products | -5.4 | -6.1 | -7.0 | -6.4 | -6.3 | -6.2 | -6.0 | -5.9 | -5.8 |
| Others | -32.3 | -32.0 | -32.9 | -34.1 | -34.6 | -34.7 | -34.7 | -35.0 | -34.9 |
| Services (net) | -2.1 | -2.6 | -3.4 | -3.4 | -3.2 | -3.0 | -3.0 | -3.0 | -3.0 |
| *Of which:* tourism receipts | 3.2 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 |
| Income (net) | -6.9 | -7.1 | -6.7 | -6.7 | -6.7 | -6.7 | -6.7 | -6.2 | -6.0 |
| *Of which:* payments on direct investments | -5.9 | -6.0 | -5.9 | -5.7 | -5.7 | -5.7 | -5.6 | -5.6 | -5.6 |
| *Of which:* public sector interest payments | -0.8 | -0.9 | -1.0 | -1.2 | -1.1 | -1.1 | -1.1 | -1.0 | -0.9 |
| Transfers (net) | 18.4 | 19.5 | 20.7 | 21.9 | 21.9 | 21.6 | 21.4 | 21.3 | 21.0 |
| *Of which:* Remittances | 17.7 | 18.6 | 20.0 | 20.9 | 20.7 | 20.4 | 20.2 | 19.8 | 19.4 |
| **Capital and Financial account** | **3.6** | **6.1** | **6.0** | **4.8** | **5.0** | **5.0** | **5.3** | **5.1** | **5.2** |
| **Financial account** | **3.0** | **5.3** | **5.3** | **4.1** | **4.2** | **4.3** | **4.5** | **4.4** | **4.5** |
| Direct investment (net) | 4.1 | 4.4 | 4.8 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 |
| Other private capital flows (net) | -1.8 | -2.5 | -0.7 | -3.4 | -1.6 | -1.3 | -1.0 | -1.2 | -0.5 |
| Public sector borrowing (net) | 0.7 | 3.4 | 1.1 | 2.6 | 0.9 | 0.7 | 0.7 | 0.7 | 0.1 |
| **Capital account** | **0.6** | **0.8** | **0.7** | **0.7** | **0.7** | **0.7** | **0.7** | **0.7** | **0.7** |
| Errors and omissions | -0.8 | -0.5 | -1.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Overall balance** | **0.2** | **3.8** | **0.2** | **0.6** | **0.7** | **0.8** | **1.1** | **1.2** | **1.3** |
| **Change in central bank reserves (- increase)** | **-0.3** | **-3.8** | **-0.2** | **-0.6** | **-0.7** | **-0.8** | **-1.1** | **-1.2** | **-1.3** |
| **Exceptional financing** | **0.1** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| **Memorandum items:** | | | | | | | | | |
| Terms of trade (percent change) | 5.5 | -2.3 | -6.3 | 1.0 | 0.5 | 1.0 | 0.0 | -0.2 | -0.2 |
| Exports of goods (percent change) | -3.2 | 8.6 | 0.3 | -0.4 | 3.1 | 4.3 | 4.8 | 4.5 | 4.6 |
| *Of Which* : volume growth (percent change) | -1.1 | 6.1 | -0.8 | 1.4 | 2.4 | 3.0 | 4.2 | 3.9 | 3.7 |
| Imports of goods (percent change) | -5.5 | 7.2 | 7.7 | 2.8 | 3.9 | 3.9 | 4.0 | 4.9 | 4.4 |
| *Of Which:* volume growth (percent change) | 1.9 | 2.4 | -0.2 | 5.8 | 3.8 | 3.0 | 2.9 | 2.9 | 2.9 |
| Gross reserves (end of period, millions of U.S. dollars) | 4,488 | 5,088 | 5,147 | 5,288 | 5,456 | 5,672 | 5,979 | 6,335 | 6,727 |
| In months of next year imports (excluding maquila) | 5.0 | 5.3 | 5.1 | 5.0 | 5.0 | 5.0 | 5.0 | 5.1 | 5.1 |
| Total external debt to GDP ratio (in percent) | 35.5 | 37.3 | 38.6 | 39.9 | 39.5 | 38.8 | 38.1 | 37.4 | 36.1 |
| Nominal GDP (millions of U.S. dollars) | 21,718 | 23,101 | 23,803 | 24,449 | 25,314 | 26,356 | 27,561 | 28,875 | 30,304 |

Sources: Central Bank of Honduras; and IMF staff estimates and projections.

## Table 6. Honduras: External Financing Needs and Sources

(In millions of U.S. dollars)

| | 2016 | 2017 | Prel. 2018 | Projections 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| Current account deficit | 567 | 409 | 1,004 | 1,030 | 1,086 | 1,108 | 1,142 | 1,113 | 1,179 |
| Debt amortizations (public and private) | 1,242 | 2,001 | 1,797 | 2,130 | 1,443 | 1,489 | 1,971 | 1,442 | 1,398 |
| **Subtotal (requirements)** | **1,809** | **2,410** | **2,801** | **3,160** | **2,530** | **2,596** | **3,113** | **2,555** | **2,577** |
| Capital account flows (net) | 130 | 181 | 168 | 177 | 184 | 191 | 200 | 209 | 220 |
| Foreign direct investment (net) | 900 | 1,013 | 1,146 | 1,188 | 1,230 | 1,281 | 1,339 | 1,403 | 1,473 |
| Public sector borrowing | 325 | 430 | 504 | 775 | 496 | 458 | 456 | 512 | 325 |
| Bonds (public) | 0 | 700 | 0 | 630 | 0 | 0 | 520 | 0 | 0 |
| Other capital flows | 520 | 971 | 1,032 | 531 | 788 | 883 | 904 | 787 | 952 |
| Change in reserves (+ decrease) | -66 | -884 | -50 | -141 | -168 | -216 | -307 | -356 | -392 |
| **Subtotal (sources)** | **1,809** | **2,410** | **2,801** | **3,160** | **2,530** | **2,596** | **3,113** | **2,555** | **2,577** |
| **Financing gap** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** |

Sources: Central Bank of Honduras and IMF staff estimates and projections.

## Table 7. Honduras: External Vulnerability Indicators

| | 2016 | 2017 | Prel. 2018 | Projections 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| Exports of goods and services, annual percent change | -2.2 | 8.0 | 0.3 | -0.1 | 3.1 | 4.3 | 4.8 | 4.5 | 4.3 |
| Imports of goods and services, annual percent change | -4.2 | 7.6 | 8.3 | 2.7 | 3.9 | 3.9 | 4.1 | 4.8 | 4.5 |
| Terms of trade (deterioration -) | 5.5 | -2.3 | -6.3 | 1.0 | 0.5 | 1.0 | 0.0 | -0.2 | -0.2 |
| Real effective exchange rate (eop, depreciation -) | -2.2 | -0.7 | 1.1 | … | … | … | … | … | … |
| Current account balance (percent of GDP) | -2.6 | -1.8 | -4.2 | -4.2 | -4.3 | -4.2 | -4.1 | -3.9 | -3.9 |
| Capital and financial account (percent of GDP) | 3.6 | 6.1 | 6.0 | 4.8 | 5.0 | 5.0 | 5.3 | 5.1 | 5.2 |
| External public debt (percent of GDP) | 28.4 | 30.5 | 31.0 | 32.9 | 32.6 | 32.0 | 31.3 | 30.6 | 29.3 |
| Gross official reserves | | | | | | | | | |
| in millions of U.S. dollars | 4,488 | 5,088 | 5,147 | 5,288 | 5,456 | 5,672 | 5,979 | 6,335 | 6,727 |
| in percent of short-term external debt | 962 | 1,057 | 737 | 1,445 | 1,440 | 1,438 | 1,450 | 1,466 | 1,483 |
| Net international reserves | | | | | | | | | |
| in millions of U.S. dollars | 3,075 | 3,503 | 3,718 | 3,858 | 4,025 | 4,241 | 4,548 | 4,904 | 5,296 |
| in percent of short-term external debt | 659 | 727 | 508 | 1,009 | 1,019 | 1,034 | 1,063 | 1,097 | 1,132 |

Sources: Central Bank of Honduras and IMF staff estimates and projections.

## Table 8. Honduras: Medium-term Macroeconomic Framework

(In percent of GDP. unless otherwise specified)

| | 2014 | 2015 | 2016 | 2017 | Prel. 2018 | Projections 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Growth and prices (in percent)** | | | | | | | | | | | |
| Real GDP growth | 3.1 | 3.8 | 3.8 | 4.9 | 3.7 | 3.4 | 3.5 | 3.6 | 3.7 | 3.9 | 3.9 |
| GDP deflator | 6.8 | 6.9 | 3.8 | 4.3 | 1.8 | 3.2 | 3.4 | 3.2 | 3.5 | 3.6 | 3.7 |
| CPI inflation (eop) | 5.8 | 2.4 | 3.3 | 4.7 | 4.2 | 4.4 | 4.2 | 4.0 | 4.0 | 4.0 | 4.0 |
| **Investment and saving** | | | | | | | | | | | |
| **Gross domestic investment** | **23.0** | **26.4** | **23.4** | **24.3** | **25.7** | **25.7** | **26.9** | **27.5** | **27.7** | **28.3** | **29.0** |
| Private sector | 19.2 | 22.6 | 20.2 | 19.9 | 21.3 | 21.7 | 22.6 | 22.8 | 23.1 | 23.5 | 24.1 |
| Public sector | 3.8 | 3.8 | 3.2 | 4.4 | 4.4 | 4.0 | 4.3 | 4.7 | 4.6 | 4.8 | 4.9 |
| **Gross national savings** | **16.0** | **21.7** | **20.8** | **22.6** | **21.5** | **21.5** | **22.6** | **23.3** | **23.6** | **24.4** | **25.1** |
| Private sector | 16.4 | 19.0 | 18.2 | 19.0 | 18.1 | 18.5 | 19.2 | 19.5 | 19.8 | 20.6 | 21.1 |
| Public sector | -0.3 | 2.8 | 2.6 | 3.5 | 3.3 | 3.0 | 3.4 | 3.8 | 3.7 | 3.9 | 4.0 |
| **Balance of payments** | | | | | | | | | | | |
| External current account | -6.9 | -4.7 | -2.6 | -1.8 | -4.2 | -4.2 | -4.3 | -4.2 | -4.1 | -3.9 | -3.9 |
| Non oil current account | 3.6 | 1.8 | 2.8 | 4.3 | 2.7 | 2.2 | 2.0 | 2.0 | 1.9 | 2.0 | 1.9 |
| Gross international reserves (millions of dollars) | 3,698 | 4,187 | 4,488 | 5,088 | 5,147 | 5,288 | 5,456 | 5,672 | 5,979 | 6,335 | 6,727 |
| Terms of Trade (annual percent change) | 5.5 | 11.1 | 5.5 | -2.3 | -6.3 | 1.0 | 0.5 | 1.0 | 0.0 | -0.2 | -0.2 |
| **External debt** | **37.3** | **36.2** | **35.5** | **37.3** | **38.6** | **39.9** | **39.5** | **38.8** | **38.1** | **37.4** | **36.1** |
| **Nonfinancial public sector** | | | | | | | | | | | |
| Revenue | 31.0 | 31.0 | 32.3 | 31.9 | 31.7 | 32.6 | 32.8 | 33.0 | 33.0 | 33.1 | 33.3 |
| *Of which:* Non-interest revenue and grants | 29.4 | 29.8 | 30.4 | 30.3 | 30.1 | 30.9 | 31.3 | 31.7 | 31.8 | 31.9 | 32.1 |
| Expenditure | 34.9 | 31.9 | 32.8 | 32.7 | 32.7 | 33.5 | 33.7 | 33.8 | 33.8 | 33.9 | 34.1 |
| **Primary balance** | **-3.4** | **0.1** | **0.3** | **0.1** | **0.0** | **0.6** | **0.7** | **0.8** | **1.0** | **0.9** | **0.9** |
| **Overall balance** | **-3.9** | **-0.9** | **-0.5** | **-0.8** | **-0.9** | **-0.9** | **-0.8** | **-0.8** | **-0.8** | **-0.8** | **-0.8** |
| **Central government** | | | | | | | | | | | |
| Revenue | 18.3 | 19.2 | 20.0 | 20.3 | 20.4 | 20.0 | 20.4 | 20.3 | 20.4 | 20.5 | 20.5 |
| Expenditure | 22.9 | 22.1 | 22.8 | 23.0 | 22.4 | 22.6 | 23.1 | 23.4 | 23.5 | 23.6 | 23.5 |
| *Of which:* Non-interest expenditure | 20.4 | 19.5 | 20.2 | 20.3 | 19.4 | 19.2 | 19.9 | 20.4 | 20.4 | 20.6 | 20.6 |
| **Primary balance** | **-2.1** | **-0.4** | **-0.1** | **-0.1** | **0.8** | **0.6** | **0.3** | **-0.2** | **-0.1** | **-0.3** | **-0.3** |
| **Overall balance** | **-4.5** | **-3.0** | **-2.7** | **-2.7** | **-2.0** | **-2.5** | **-2.7** | **-3.1** | **-3.1** | **-3.1** | **-3.1** |
| **Nonfinancial public sector debt** | | | | | | | | | | | |
| Total | **39.3** | **39.0** | **39.9** | **39.9** | **41.8** | **42.1** | **42.0** | **41.9** | **41.4** | **40.9** | **39.9** |
| Domestic debt | 11.1 | 10.8 | 11.5 | 9.4 | 10.8 | 9.2 | 9.4 | 9.9 | 10.1 | 10.3 | 10.6 |
| External debt | 28.3 | 28.2 | 28.4 | 30.5 | 31.0 | 32.9 | 32.6 | 32.0 | 31.3 | 30.6 | 29.3 |
| **Monetary and financial** | | | | | | | | | | | |
| Broad money (percentage change) | 13.3 | 9.0 | 15.6 | 12.8 | 8.3 | 9.0 | 11.0 | 11.2 | 13.4 | 11.2 | 12.2 |
| Private sector credit (percentage change) | 10.8 | 10.0 | 12.9 | 9.4 | 13.4 | 11.6 | 9.0 | 8.1 | 7.9 | 7.8 | 7.2 |
| Bank assets | 96.1 | 97.0 | 97.8 | 97.8 | 105.0 | 109.9 | 111.9 | 113.0 | 113.6 | 113.8 | 113.1 |
| Private credit | 54.5 | 54.0 | 56.6 | 56.6 | 60.7 | 63.5 | 64.7 | 65.4 | 65.7 | 65.8 | 65.4 |
| Non-performing loans to total loans (ratio) | 3.3 | 3.0 | 2.8 | 2.3 | 2.4 | … | … | … | … | … | … |
| Capital adequacy (percent) | 14.6 | 14.0 | 13.8 | 13.7 | 13.4 | … | … | … | … | … | … |
| **Memorandum items:** | | | | | | | | | | | |
| Nominal GDP (in billions of lempiras) | 415 | 460 | 496 | 543 | 573 | 611 | 654 | 699 | 751 | 808 | 872 |

Sources: Central Bank of Honduras, Ministry of Finance, and Fund staff estimates and projections.

## Table 9. Honduras: Structure and Performance of the Banking Sector 1/

(In percent, unless otherwise indicated)

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019M3 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Total assets (in millions of Lempiras) 2/** | **236,665** | **270,981** | **302,662** | **341,614** | **393,763** | **432,178** | **473,722** | **521,869** | **579,373** | **581,308** |
| (In percent of GDP) | 79 | 81 | 84 | 91 | 95 | 94 | 96 | 96 | 101 | 95 |
| **Number of banks** | **17** | **17** | **17** | **17** | **17** | **15** | **15** | **15** | **15** | **15** |
| Domestic | 8 | 7 | 7 | 7 | 8 | 6 | 6 | 6 | 6 | 6 |
| Foreign | 9 | 10 | 10 | 10 | 9 | 9 | 9 | 9 | 9 | 9 |
| **Bank concentration** | | | | | | | | | | |
| Number of banks accounting for at least | | | | | | | | | | |
| 25 percent of total assets | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| 75 percent of total assets | 6 | 6 | 6 | 6 | 6 | 5 | 5 | 5 | 5 | 5 |
| **Capital adequacy** | | | | | | | | | | |
| Regulatory capital to risk weighted assets (RWA) | 14.9 | 14.9 | 14.7 | 14.5 | 14.6 | 14.0 | 13.8 | 13.7 | 13.4 | 13.2 |
| Capital (net worth) to assets | 9.2 | 9.1 | 9.3 | 9.1 | 9.2 | 8.7 | 8.7 | 8.7 | 8.7 | 8.8 |
| **Asset quality and composition** | | | | | | | | | | |
| Nonperforming loans( NPLs) to total loans 3/ | 3.7 | 2.9 | 3.3 | 3.4 | 3.3 | 3.0 | 2.9 | 2.3 | 2.1 | 2.3 |
| NPLs net of provisions to capital | -4.4 | -6.5 | -4.6 | -5.2 | -5.2 | -5.1 | -3.4 | -5.8 | -5.8 | -4.7 |
| Restructured loans to regulatory capital | 19.8 | 26.6 | 24.7 | 25.3 | 22.3 | 27.9 | 23.7 | 25.0 | 25.0 | 25.9 |
| Non earning assets net of provisions | | | | | | | | | | |
| to regulatory capital | 47.9 | 46.9 | 45.0 | 44.1 | 51.2 | 54.6 | 48.4 | 41.6 | 42.4 | 42.0 |
| Provisions to total loans | 4.3 | 3.9 | 4.0 | 4.2 | 4.1 | 3.8 | 3.4 | 3.2 | 3.0 | 3.0 |
| Provisions to NPLs 2/ | 118.9 | 135.0 | 121.8 | 123.7 | 125.5 | 126.1 | 117.4 | 138.0 | 140.2 | 129.7 |
| Sectoral distribution of loans to total loans: | | | | | | | | | | |
| Commerce | 12.7 | 13.0 | 14.4 | 14.3 | 14.3 | 13.6 | 13.0 | 14.9 | 15.2 | 15.2 |
| Construction and real estate | 34.2 | 32.9 | 30.8 | 28.9 | 27.1 | 24.6 | 23.6 | 23.3 | 23.0 | 22.7 |
| Agriculture and related sectors | 0.0 | 0.0 | 4.4 | 4.7 | 5.0 | 5.9 | 7.2 | 7.4 | 7.5 | 7.7 |
| Industry | 13.6 | 12.3 | 11.7 | 11.9 | 11.1 | 11.1 | 10.4 | 10.3 | 10.8 | |
| Consumption | 16.5 | 18.3 | 20.5 | 21.9 | 21.0 | 21.3 | 23.1 | 20.9 | 21.1 | 20.3 |
| Other | 0.0 | 0.0 | 18.2 | 18.0 | 21.3 | 23.5 | 22.5 | 23.0 | 21.9 | 23.0 |
| **Profitability** | | | | | | | | | | |
| Return on assets (ROA) | 1.3 | 1.3 | 1.5 | 1.4 | 1.4 | 1.4 | 1.3 | 1.2 | 1.2 | 1.2 |
| Return on equity (ROE) | 12.5 | 13.2 | 15.9 | 14.5 | 13.4 | 14.6 | 14.6 | 12.0 | 12.0 | 11.7 |
| Interest margin to total income | 48.2 | 48.9 | 52.1 | 47.5 | 52.1 | 52.8 | 52.9 | 51.1 | 49.6 | 49.0 |
| Personnel expenses to administrative expenses | 39.6 | 39.6 | 39.4 | 41.8 | 41.7 | 42.0 | 41.8 | 45.5 | 45.1 | 45.1 |
| **Liquidity** | | | | | | | | | | |
| Liquid assets to total assets | 24.4 | 24.3 | 21.4 | 25.0 | 25.2 | 24.6 | 24.3 | 26.3 | 22.2 | 22.7 |
| Liquid assets to total short-term liabilities | 58.2 | 58.8 | 56.2 | 69.7 | 70.8 | 69.5 | 66.3 | 71.5 | 61.7 | 61.8 |
| **Dollarization** | | | | | | | | | | |
| Deposits in foreign currency in percent of total | 29.5 | 29.1 | 30.6 | 30.6 | 32.0 | 29.8 | 30.2 | 29.9 | 28.9 | 29.6 |
| Credit in foreign currency in percent of total | 28.3 | 30.1 | 31.2 | 33.5 | 34.7 | 33.2 | 32.1 | 31.2 | 31.8 | 32.1 |

Source: National Commission of Banking and Insurance.
1/ The information covers only private banks.
2/ Includes contingent assets.
3/ As of 2012 NPLs include delinquency of restructured loans.

## Table 10. Honduras: Disbursements, Purchases, and Timing of Reviews Under the SBA/SCF Arrangements, 2019-21

| | | Amount (millions of SDRs) | | | Percent of quota | | |
|---|---|---|---|---|---|---|---|
| Date of Availability | Conditions | Total | SCF | SBA | Total | SCF | SBA |
| Board approval | Approval of the arrangement | 74.940 | 12.490 | 62.450 | 30.00 | 5.00 | 25.00 |
| December 1, 2019 | Observance of end-September 2019 performance criteria and continuous performance criteria and completion of first reviews | 29.976 | 12.490 | 17.486 | 12.00 | 5.00 | 7.00 |
| April 1, 2020 | Observance of end-December 2019 performance criteria and continuous performance criteria and completion of second reviews | 29.976 | 12.490 | 17.486 | 12.00 | 5.00 | 7.00 |
| October 1, 2020 | Observance of end-June 2020 performance criteria and continuous performance criteria and completion of third reviews | 29.976 | 12.490 | 17.486 | 12.00 | 5.00 | 7.00 |
| March 1, 2021 | Observance of end-December 2020 performance criteria and continuous performance criteria and completion of fourth reviews | 29.976 | 12.490 | 17.486 | 12.00 | 5.00 | 7.00 |
| June 20, 2021 | Observance of end-March 2021 performance criteria and continuous performance criteria and completion of fifth reviews | 29.976 | 12.490 | 17.486 | 12.00 | 5.00 | 7.00 |
| | Total | 224.820 | 74.940 | 149.880 | 90.00 | 30.00 | 60.00 |

* Honduras' quota is SDR 249.8 million.

## Table 11. Honduras: Indicators of Fund Credit, 2019-28 1/

(As of May 23, 2019; in units indicated)

| | Projections | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
| **Existing Fund credit** | | | | | | | | | | |
| Stock, in millions of SDRs 2/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Obligations, in millions of SDRs | 0.6 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| **Proposed SCF** | | | | | | | | | | |
| Stock, in millions of SDRs 2/ | 25.0 | 50.0 | 74.9 | 74.9 | 72.2 | 62.5 | 45.8 | 29.2 | 12.5 | 2.8 |
| Disbursements, in millions of SDRs | 25.0 | 25.0 | 25.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Obligations, in millions of SDRs 3/ | 0.0 | 0.0 | 0.2 | 0.2 | 3.0 | 9.9 | 16.8 | 16.7 | 16.7 | 9.7 |
| Principal, in millions of SDRs | 0.0 | 0.0 | 0.0 | 0.0 | 2.8 | 9.7 | 16.7 | 16.7 | 16.7 | 9.7 |
| Interest and charges, in millions of SDRs | 0.0 | 0.0 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.0 |
| **Proposed SBA** | | | | | | | | | | |
| Stock, in millions of SDRs 2/ | 79.9 | 114.9 | 149.9 | 134.3 | 97.7 | 37.2 | 6.6 | 0.0 | 0.0 | 0.0 |
| Disbursements, in millions of SDRs | 79.9 | 35.0 | 35.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Obligations, in millions of SDRs 4/ | 1.3 | 2.9 | 3.8 | 19.6 | 40.0 | 62.9 | 31.9 | 7.4 | 0.8 | 0.8 |
| Principal, in millions of SDRs | 0.0 | 0.0 | 0.0 | 15.6 | 36.5 | 60.6 | 30.6 | 6.6 | 0.0 | 0.0 |
| Interest and charges, in millions of SDRs | 1.3 | 2.9 | 3.8 | 4.0 | 3.4 | 2.3 | 1.3 | 0.9 | 0.8 | 0.8 |
| **Stock of existing and prospective Fund credit 2/** | | | | | | | | | | |
| In millions of SDRs | 104.9 | 164.9 | 224.8 | 209.2 | 169.9 | 99.6 | 52.4 | 29.2 | 12.5 | 2.8 |
| In percent of quota | 42.0 | 66.0 | 90.0 | 83.8 | 68.0 | 39.9 | 21.0 | 11.7 | 5.0 | 1.1 |
| In percent of exports of goods and services | 1.4 | 2.1 | 2.8 | 2.5 | 2.0 | 1.1 | 0.6 | 0.3 | 0.1 | 0.0 |
| In percent of external debt | 1.6 | 2.4 | 3.2 | 2.9 | 2.3 | 1.3 | 0.7 | 0.4 | 0.2 | 0.0 |
| In percent of gross reserves | 2.8 | 4.2 | 5.5 | 4.9 | 3.8 | 2.1 | 1.3 | 0.7 | 0.3 | 0.1 |
| **Obligations to the Fund from existing arrangements and prospective Fund arrangements** | | | | | | | | | | |
| In millions of SDRs | 1.9 | 3.7 | 4.8 | 20.6 | 43.7 | 73.6 | 49.5 | 25.0 | 18.3 | 11.3 |
| In percent of quota | 0.7 | 1.5 | 1.9 | 8.2 | 17.5 | 29.5 | 19.8 | 10.0 | 7.3 | 4.5 |
| In percent of exports of goods and services | 0.0 | 0.0 | 0.1 | 0.2 | 0.5 | 0.8 | 0.5 | 0.3 | 0.2 | 0.1 |
| In percent of external debt | 0.0 | 0.1 | 0.1 | 0.3 | 0.6 | 1.0 | 0.6 | 0.3 | 0.2 | 0.1 |
| In percent of gross reserves | 0.0 | 0.1 | 0.1 | 0.5 | 1.0 | 1.6 | 1.2 | 0.6 | 0.4 | 0.2 |

1/ This table of capacity to pay indicators is prepared based on an adverse scenario in which more modest terms of trade growth—a ½ percent increase compared to 2 percent in the baseline—would lead to lower growth, a higher current account deficit, and slighlty higher public debt (the authorities would still comply with the FRL, but they would not overperform). The higher external deficit would open a financing gap of about 90 percent of quota.

2/ End of period.

3/ Expected SCF repayment schedule, assuming full drawings and interest at zero percent through end 2020 and 0.25 percent thereafter. The Honduran authorities have the intention to treat the arrangement as precautionary.

4/ Expected repayment schedule SBA, assuming full drawings and a rate of charge of 2.147 percent. The Honduran authorities have expressed their intention to treat the arrangement as precautionary, since balance of payment pressures have not materialized.

## Table 12. Honduras: Sustainable Development Goals

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|
| **Goal 1. End poverty in all its forms everywhere** | | | | | | | |
| Proportion of population below international poverty line (%) | 19.6 | 17.3 | 15.9 | 16.2 | 16.0 | .. | .. |
| Proportion of population living below the national poverty line (%) | 66.5 | 64.5 | 62.8 | 63.8 | 60.9 | .. | .. |
| **Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture** | | | | | | | |
| Prevalence of undernourishment (% of population) | 15.3 | 15.4 | 15.6 | 15.5 | 15.3 | .. | .. |
| **Goal 3. Ensure healthy lives and promote well-being for all at all ages** | | | | | | | |
| Mortality rate, infant (per 1,000 live births) | 18.6 | 18.0 | 17.3 | 16.7 | 16.2 | 15.6 | .. |
| Mortality rate, under 5 (per 1,000 live births) | 21.9 | 21.0 | 20.3 | 19.6 | 18.9 | 18.2 | .. |
| Maternal mortality ratio (per 100,000 live births) | 141.0 | 135.0 | 132.0 | 129.0 | .. | .. | .. |
| Prevalence of HIV, total (% of population ages 15-49) | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 | .. |
| **Goal 4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all** | | | | | | | |
| Minimum proficiency in mathematics, secondary (%) | .. | 58.2 | 92.0 | 85.0 | 92.0 | .. | .. |
| Minimum proficiency in reading, secondary (%) | .. | 70.4 | 93.0 | 80.0 | 93.0 | .. | .. |
| Gender parity index for achievement in mathematics, secondary | .. | 1.0 | .. | .. | .. | .. | .. |
| Gender parity index for achievement in reading, secondary | .. | 1.1 | .. | .. | .. | .. | .. |
| Rural to urban parity index for achievement in mathematics, secondary | .. | 0.8 | .. | .. | .. | .. | .. |
| Rural to urban parity index for achievement in reading, secondary | .. | 0.9 | .. | .. | .. | .. | .. |
| **Goal 5. Achieve gender equality and empower all women and girls** | | | | | | | |
| Proportion of seats held by women in national parliaments (%) | 19.5 | 19.5 | 25.8 | 25.8 | 25.8 | 25.8 | 21.1 |
| Proportion of women in managerial positions (%) | 59.5 | 61.3 | 59.9 | 49.1 | 47.0 | 48.4 | .. |
| **Goal 6. Ensure availability and sustainable management of water and sanitation for all** | | | | | | | |
| Proportion of population with basic handwashing facilities on premises, rural (%) | 80.3 | 80.3 | 80.3 | 80.3 | .. | .. | .. |
| Proportion of population with basic handwashing facilities on premises, urban (%) | 87.2 | 87.2 | 87.2 | 87.2 | .. | .. | .. |
| **Goal 7. Ensure access to affordable, reliable, sustainable and modern energy for all** | | | | | | | |
| Proportion of population with primary reliance on clean fuels and technology (%) | .. | .. | .. | 51.0 | 52.0 | 54.0 | .. |
| Renewable energy share in total energy consumption (%) | 54.3 | 53.4 | 54.1 | 53.5 | 55.2 | .. | .. |
| **Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all** | | | | | | | |
| Annual growth rate of real GDP per capita (%) | 2.2 | 1.0 | 1.3 | 2.1 | 2.0 | 3.1 | .. |
| Proportion of informal employment in non-agriculture employment (%) | 75.2 | 75.3 | 73.3 | 74.2 | 73.8 | .. | .. |
| Proportion of youth not in education, employment or training (%) | 28.7 | 26.8 | 28.7 | 27.0 | 27.8 | 27.7 | .. |
| **Goal 9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation** | | | | | | | |
| Manufacturing value added as a proportion of GDP (%) | 16.3 | 16.4 | 16.3 | 16.3 | 16.2 | 16.2 | 16.2 |
| Researchers (in full-time equivalent) per million inhabitants (per 1,000,000 population) | .. | .. | .. | 23.0 | .. | .. | .. |
| Proportion of medium and high-tech industry value added in total value added (%) | 7.2 | 7.2 | 7.2 | 7.2 | 7.2 | .. | .. |
| **Goal 10. Reduce inequality within and among countries** | | | | | | | |
| Growth rate of household expenditure or income per capita (%) | .. | .. | .. | -4.2 | .. | .. | .. |
| Remittance costs as a proportion of the amount remitted (%) | .. | .. | .. | 4.3 | .. | 4.2 | .. |
| **Goal 11. Make cities and human settlements inclusive, safe, resilient and sustainable** | | | | | | | |
| Annual mean levels of fine particulate matter in cities, total population (micrograms per cubic meter) | .. | .. | .. | .. | 20.1 | .. | .. |
| **Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development** | | | | | | | |
| Average proportion of Marine Key Biodiversity Areas (KBAs) covered by protected areas (%) | 1.5 | 48.9 | 48.9 | 48.9 | 48.9 | 48.9 | 48.9 |
| **Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels** | | | | | | | |
| Number of victims of intentional homicide per 100,000 population | 84.3 | .. | 66.9 | .. | 56.5 | .. | .. |
| Bribery incidence (% of firms experiencing at least one bribe payment request) | .. | .. | .. | .. | 8.7 | .. | .. |

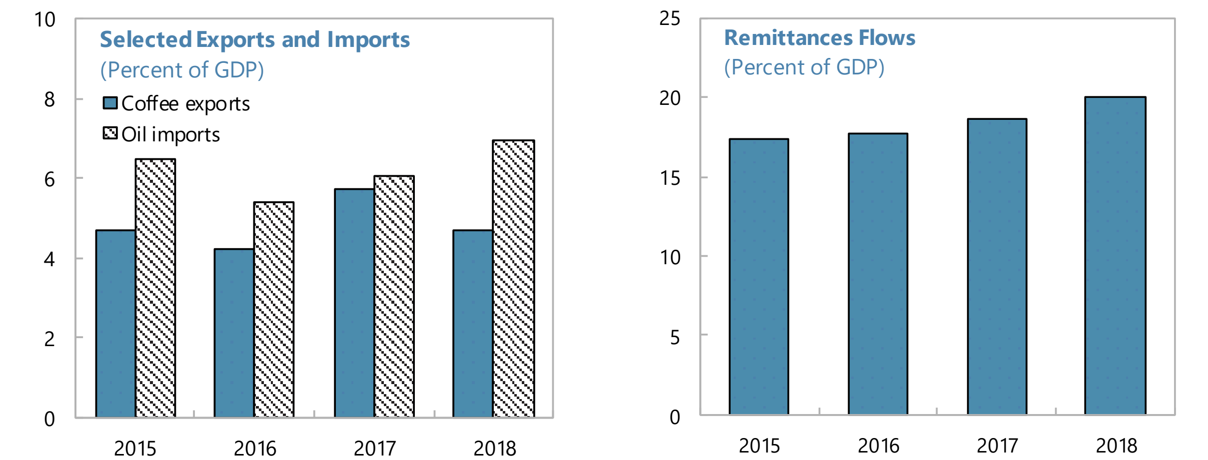
Source: UN SDG Indicators Global Database.
Note: Goals 12, 13 and 17 are not listed due to data limitations.

# Annex I. External Sector Assessment

*The 2018 external position in Honduras is broadly in line with medium-term fundamentals and desirable policies. Risks to external stability are mitigated by stable FDI inflows and a projected declining trend for external debt. Reserve coverage is adequate and is expected to continue to be over the medium-term.*

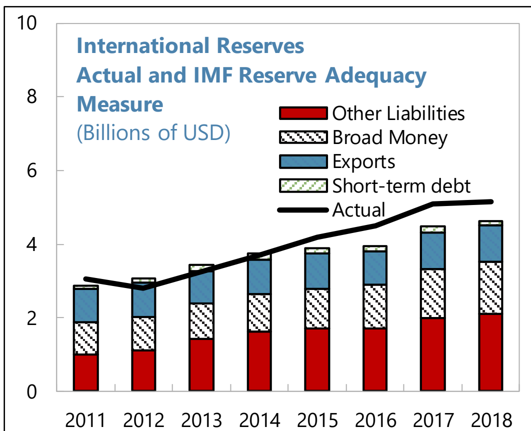
**1. The CA deficit increased to 4¼ percent of GDP in 2018, from 1¾ percent of GDP in 2017.** Reflecting worsening terms of trade, the trade balance deteriorated, driven by underperforming coffee and maquila exports and a higher oil imports bill. Although tourism receipts remained stable, high oil prices also impacted freights and negatively affected the services balance. Strong remittance growth—which increased by about 1.5 percent of GDP—partially offset otherwise declining current account flows.

Current Account Drivers



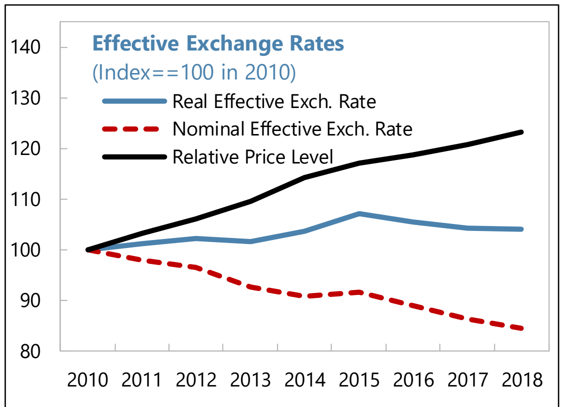

Sources: Central Bank of Honduras and IMF staff calculations.

**2. International reserves increased by US$50 million in 2018; and remain within the range recommended by the reserve adequacy measure.** The stock of reserves reached 5.1 months of non-maquila imports of goods and services. As Honduras's exchange rate arrangement is classified as a crawling-peg, the reserve coverage is compared to the metric for non-floating exchange rate regimes. It stood at 111 percent of the metric in 2018, and it is expected to remain in the recommended 100-150 percent range over the medium-term.



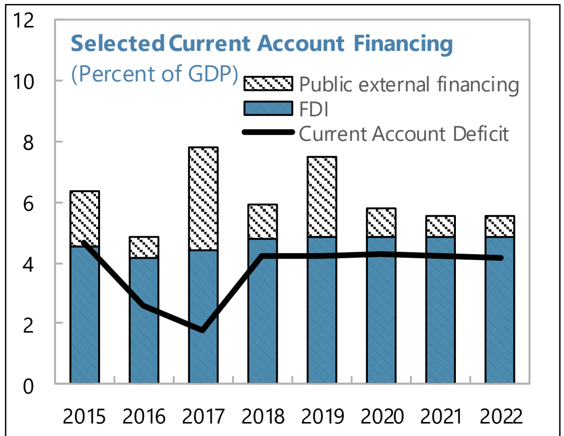

Sources: Central Bank of Honduras and IMF staff calculations.

**3. The real effective exchange rate remained stable in 2018.** The stability of the REER in 2018 reflects a nominal exchange rate depreciation of 2 percent that is offset by Honduras's higher price level compared to its trading partners. The nominal exchange rate depreciation responds to the adjustment rule embedded in the crawling peg regime—which depends on the differential between the domestic and trading partners' inflation, as well as changes in the exchange rates of these countries' currencies vis-à-vis the U.S. dollar. Since 2015, the modest REER depreciation reflects a gradual nominal exchange rate adjustment, in line with global financial conditions and moderate inflation differential with respect to peers.



Sources: Central Bank of Honduras and IMF staff calculations.

**4. The financing structure of the current account supports external stability.** In line with historical experience, the CA deficit was primarily financed by FDI inflows, which reached 4.8 percent of GDP in 2018. Over the medium-term, FDI flows are projected to be stable, as well as public external financing—mostly concessional borrowing and the rollover of existing Eurobonds (2013, 2017).

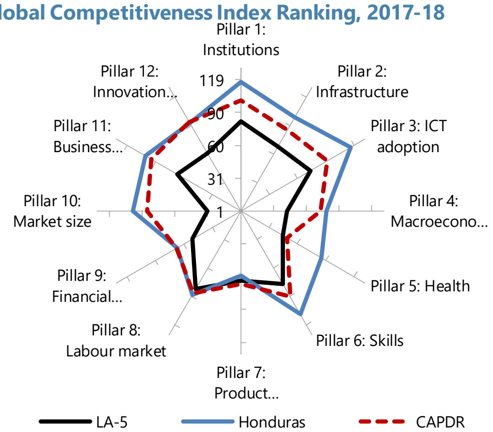


Sources: Central Bank of Honduras and IMF staff

**5. The external balance sheet remains sound.** The net international investment position deteriorated from 65 percent of GDP in 2017 to 69.5 percent of GDP in 2018, mostly driven by an increase in foreign direct investment which constitutes most of the IIP liabilities (60 percent). The external debt reached 39.4 percent of GDP in 2018, increasing from 37.4 in 2017. In terms of composition, external debt is mostly public (80 percent of total) and the financial sector makes-up for close to 90 percent of private external debt. Over the medium-term, external debt is projected to decline and to be sustainable under various shocks (see DSA Annex).

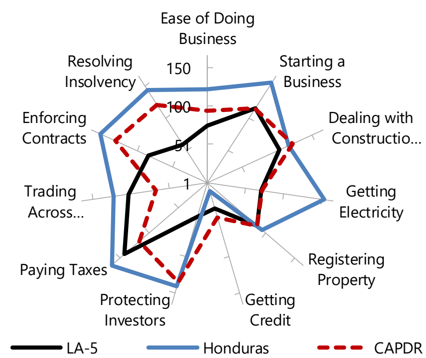
**6. Honduras has recently made marginal improvements in non-price external competitiveness indicators; but remains less competitive compared to its peers.** According to the 2018 Global Competitiveness Index, Honduras particularly lags behind CAPDR peers in the areas of health and institutions. In terms of Doing Business indicators, Honduras non-price competitiveness could be further improved by addressing challenges in the electricity sector.

**Global Competitiveness Index Ranking, 2017-18**




Source: Global Competitiveness Report 2018, and IMF staff calculations.

**Doing Business Ranking, 2019**




Sources: Doing Business 2019, and IMF staff calculations.

## External Balance Assessment (EBA)

7. **The EBA suggests that the external position of Honduras is broadly consistent with fundamentals and desirable policies.** The EBA toolkit includes the current account balance model, the behavior of the real effective exchange rate, and intertemporal budget constraint analysis. In addition, staff assessment of the real effective exchange rate movements in recent years does not point to misalignment. The results of the analysis using each methodology are summarized below:

| EBA - Current Account Model | |
|---|---|
| **CA-Actual** | -4.2% |
| Cyclical Contributions (from model) | -1.0% |
| additional temporary factors | 1.5% |
| **Cyclically adjusted CA** | -4.7% |
| **CA-Norm** | -7.0% |
| **Cyclically adjusted CA Norm** | -5.9% |
| **Multilaterally Consistent Cyclically adjusted CA Norm** | -5.4% |
| **CA-Gap** | 0.7% |
| of/which Policy gap | -0.7% |
| Elasticity | -0.36 |
| **REER Gap** | -1.9% |
| CA-Fitted | -7.7% |
| Residual | 0.03 |
| Natural Disasters and Conflicts | 0.0% |

- *The CA model in the EBA assessment estimates the REER for Honduras to be broadly consistent with fundamentals and desirable policies.* Staff adjusted the 2018 CA outturn for cyclical factors and the surge in remittances flows in 2018 (which has reduced the actual CA deficit by 1.5 percent of GDP), leading to a cyclically adjusted CA of -4.7 percent of GDP. Remittances flows in 2018 increased more than expected in the last Staff Report, to 20 percent of GDP. The sharp increase in remittances flows since 2017 reflects the increase in policy uncertainty regarding how changes in the U.S. immigration policy could affect Hondurans living in the U.S.; which is likely to remain elevated until the expiration of the Temporary Protection Status takes place in 2020. The surge in remittances is judged as temporary, and the staff's baseline scenario projects that remittances flows will decline by about 1½ percent of GDP by 2024, converging to levels broadly in line with historical trends. In comparison, the EBA-lite model calculates a cyclically adjusted CA norm of -5.4 percent of GDP. This norm reflects the effects from lagging productivity growth, favorable demographics, high migrant share, and relatively high projected medium-term growth. The difference between the cyclically adjusted 2018 CA and the CA norm leads to a CA gap of 0.7 percent of GDP, consistent with a REER undervaluation of 1.9 percent. Of the CA gap, -0.7 percent of GDP corresponds to a policy gap, which mainly reflects Honduras' relatively closed capital account compared to the rest of the world.

- *The REER index model in the EBA assessment shows an overvaluation of about 6 percent.* The REER fitted value from the model is mostly driven by the fact that Honduras a) is not a reserve currency holder and b) exhibits a negative oil balance. As in the current account model, the policy gap is mainly explained by the relatively close capital account in Honduras. Staff assessment is that the REER is not overvalued considering, *inter alia*, that the multilateral exchange rate has continued to depreciate in recent years and the inflation differentials between Honduras and its peers are not large (about 2 percent per year in the last 5 years, on average).

| EBA - REER Index Model | |
|---|---|
| Ln(REER) Actual | 4.65 |
| Ln(REER) Fitted | 4.64 |
| Ln(REER) Norm | 4.59 |
| Residual | 0.00 |
| REER Gap | 5.7% |
| Policy Gap | 5% |
| Natural Disasters and Conflicts | 0.4% |

- *The external sustainability module—based on an inter-temporal budget constraint perspective—suggests that the REER is in line with fundamentals.* Stabilizing Honduras IIP to the 2018 level of -69.5 percent of GDP over the medium-term would not require an adjustment of the REER, as the estimated gap from the model is within the 1 percent range. The model parameters are calibrated at 99.7 percent for the foreign currency share of assets in the IIP, and 40 percent for the foreign currency share of foreign liabilities.

# Annex II. Debt Sustainability Analysis

*The Debt Sustainability Analysis (DSA) indicates that Honduras stands at low risk of debt distress both for public external debt and overall debt, which represents an upgrade from the 2018 DSA, where risk of debt distress was assessed as moderate.[1,2] The DSA was undertaken under the revised debt-sustainability framework for low income countries (LIC DSF), whereby Honduras's debt carrying capacity was upgraded from medium to strong. Changes in the debt-sustainability framework have contributed to the risk of debt distress improvement. A proven record of compliance with the Fiscal Responsibility Law (FRL) and solid macroeconomic conditions also contributed to rate Honduras' risk of debt distress as low. Going forward, adherence to the FRL and institutional reforms to boost inclusive growth and increase the economy's potential are critical to maintain debt sustainability.*

| Honduras: Joint Bank-Fund Debt Sustainability Analysis | |
|---|---|
| Risk of external debt distress | Low |
| Overall risk of debt distress | Low |
| Granularity in the risk rating | Tool not applicable |
| Application of judgment | No |

## A. Background

**1. Total public debt increased slightly in 2018 due mainly to higher domestic borrowing.** Gross public debt stood at 41.8 percent of GDP at end-2018, up by almost 2 percentage points of GDP since 2017 (domestic debt comprising 1.4 percent the increase), of which 31 percentage points corresponded to external public and publicly guaranteed (PPG) debt and 10.8 percentage points to domestic debt (Text Table II.1). Regarding debt dynamics, the observed higher domestic real interest rates and real exchange rate depreciation (Table II.2) were partially offset by the contribution of real economic growth. The increase in domestic debt also portrays financial imbalances faced by the state-owned electricity company (ENEE).

**2. PPG external debt increased slightly since 2016.** Following a US$700 million international bond issuance in 2017, the PPG external debt-to-GDP ratio increased to 31 percent in 2018. Total external debt reached 38.6 percent of GDP—up from 37.3 percent in 2017—mainly driven by the increase in private external debt of 0.8 percent of GDP. Nonetheless, private external debt has declined somewhat over the last five years, easing from 9 percent of GDP in 2014 to 7.5 percent as of end 2018.

[1] This DSA updates the previous joint IMF/WB DSA prepared in June 2018 in the context of the Honduras Article IV staff report (IMF Country Report No. 18/206).

[2] Approved by Patricia Alonso-Gamo (WHD), Ana Corbacho (SPR), and Marcello Estevão (IDA).

**Text Table II.1. Honduras: PPG Debt Stock Composition by Level of Government**

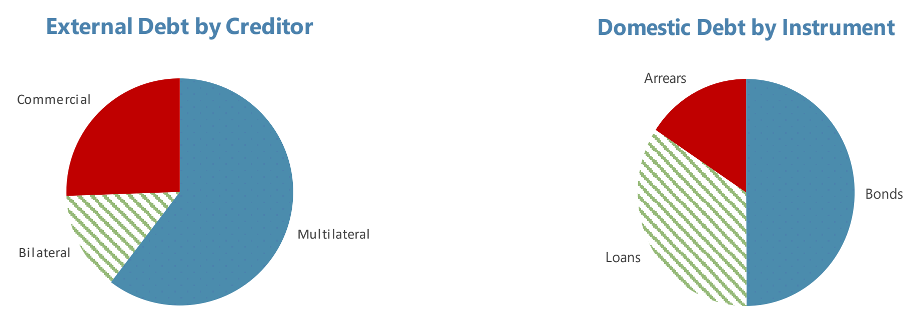
(End-of-year stock, in percent of GDP)

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| **Domestic Debt** | | | | |
| Central government | 7.8 | 8.7 | 7.1 | 7.4 |
| Local governments | 0.8 | 0.8 | 1.0 | 1.2 |
| Nonfinancial public companies | 2.2 | 2.0 | 1.2 | 2.2 |
| **Total** | **10.8** | **11.5** | **9.4** | **10.8** |
| | | | | |
| **External Debt** | | | | |
| Central government | 27.3 | 27.3 | 29.4 | 29.8 |
| Local governments | 0.0 | 0.0 | 0.0 | 0.0 |
| Nonfinancial public companies | 0.9 | 1.1 | 1.1 | 1.3 |
| **Total** | **28.2** | **28.4** | **30.5** | **31.0** |
| | | | | |
| **Total Debt** | | | | |
| Central government | 35.1 | 36.0 | 36.5 | 37.2 |
| Local governments | 0.8 | 0.8 | 1.0 | 1.2 |
| Nonfinancial public companies | 3.1 | 3.1 | 2.4 | 3.5 |
| **Total** | **39.0** | **39.9** | **39.9** | **41.8** |
| | | | | |
| **Memorandum item** | | | | |
| Private External Debt | 8.0 | 7.2 | 6.7 | 7.5 |

Source: Country authorities.

3. **Public debt is mostly held by foreign creditors** (Text Figure II.1). The share of PPG external debt stood at 74.2 percent of total public debt as of end 2018. The main creditors to Honduras are international bondholders, the Inter-American Development Bank (IDB), the Central American Bank for Economic Integration (CABEI), and the World Bank, which provide lending at long maturities, particularly in the case of the multilaterals. Public domestic debt is mainly held by commercial banks, has a shorter—though rising—maturity (over 4 years), and carries a higher real interest rate. In March 2018, the government placed a 15-year bond in the local market at a fixed interest rate of 11 percent raising 154 million Lempiras. This reflects a broader strategy by the authorities to increase Lempiras-denominated debt with longer maturities, to be held increasingly by pension funds and other institutional investors.

**Text Figure II.1. Honduras. PPG Debt Stock Composition by Instrument**




Source: Country authorities.

**4. The debt coverage for the public sector is comprehensive.** The DSA covers the nonfinancial public sector (NFPS). Therefore, it includes general government debt and non-financial state-owned enterprises' debt, both guaranteed and non guaranteed. Debt from extrabudgetary funds such as trust funds[3]—which are treated as private entities under Honduran legislation but should be registered as general goverment units according to the 2014 GFSM—are also included (Text Table II.2).[4] Decentralized agencies such as public universities, among others, are included. Public pension funds debt and central bank debt borrowed on behalf of the government are also covered in the debt stock. Among debt for non-financial SOEs, in the case of ENEE, this includes arrears to energy generators. The contingent liability test includes lawsuits related to labor and administrative disputes in the amount of 4 percent of GDP,[5] PPPs for 4 percent of GDP, and the default financial market shock (5 percent of GDP). Since the DSA coverage does not include public banks, an additional 2 percent of GDP is added to the contingent liability test. The DSA uses a currency-based definition of external debt—non-residents do not hold domestic debt, hence there is no material difference between the residency-based and the currency-based concepts. Whereby, lempiras-denominated debt is considered public domestic debt and public foreign currency-denominated debt is accounted as public external debt.

### Text Table II.2. Honduras: Public Debt Coverage and Calibration of Contingent Liability Stress Test

| | Subsectors of the public sector | Sub-sectors covered |
|---|---|---|
| 1 | Central government | X |
| 2 | State and local government | X |
| 3 | Other elements in the general government | X |
| 4 | o/w: Social security fund | X |
| 5 | o/w: Extra budgetary funds (EBFs) | X |
| 6 | Guarantees (to other entities in the public and private sector, including to SOEs) | X |
| 7 | Central bank (borrowed on behalf of the government) | X |
| 8 | Non-guaranteed SOE debt | X |

| | | | | |
|---|---|---|---|---|
| 1 | The country's coverage of public debt | The entire public sector, including SOEs | | |
| | | Default | Used for the analysis | Reasons for deviations from the default settings |
| 2 | Other elements of the general government not captured in 1. | 0 percent of GDP | 4.3 | It includes contingent liabilities for lawsuits. |
| 3 | SoE's debt (guaranteed and not guaranteed by the government) 1/ | 2 percent of GDP | 2.0 | It includes financial state-owned enterprises. |
| 4 | PPP | 35 percent of PPP stock | 3.0 | |
| 5 | Financial market (the default value of 5 percent of GDP is the minimum value) | 5 percent of GDP | 5.0 | |
| | Total (2+3+4+5) (in percent of GDP) | | 14.3 | |

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

## B. Macroeconomic and Policy Assumptions

**5. The main macroeconomic assumptions are based on the authorities' policy targets and staff projections.** The medium-to long-term macroeconomic outlook assumes that the FRL is fulfilled and that structural reforms envisaged in the Fund-supported program are implemented. As a result, the baseline macroeconomic projections are revised compared to the last DSA update dated June 2018 (Text Table II.3).

[3] Only the trust fund "*Fondo de Protección y Seguridad Poblacional*" has contracted debt.

[4] Where complete details on the debt service for local governments and trust funds are not available, conservative, commercial bank financing assumptions are used.

[5] Disputed amounts reach 9 percent of GDP, but contingent liabilities are 4 percent after factoring lawsuit-specific probabilities of resolution according to estimations prepared by the Treasury's contingency unit.

**Text Table II.3. Honduras: Selected Economic Indicators, Current vs Previous DSA**

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2028 | 2038 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Real GDP (percent change)** | | | | | | | | | | | |
| Current DSA | 3.8 | 4.9 | 3.7 | 3.4 | 3.5 | 3.6 | 3.7 | 3.9 | 3.9 | 3.9 | 3.9 |
| Previous DSA | 3.8 | 4.8 | 3.7 | 3.7 | 3.7 | 3.7 | 3.8 | 3.8 | 3.8 | 3.8 | 3.8 |
| **GDP deflator (percent change)** | | | | | | | | | | | |
| Current DSA | 3.8 | 4.3 | 1.8 | 3.2 | 3.4 | 3.2 | 3.5 | 3.6 | 3.7 | 4.0 | 4.0 |
| Previous DSA | 3.5 | 4.2 | 4.2 | 4.3 | 4.1 | 4.1 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| **Primary balance (percent of GDP)** | | | | | | | | | | | |
| Current DSA | 0.3 | 0.1 | 0.0 | 0.6 | 0.7 | 0.8 | 1.0 | 0.9 | 0.9 | 0.8 | 1.1 |
| Previous DSA | -0.7 | -0.4 | 0.2 | 0.5 | 0.7 | 0.6 | 0.5 | 0.6 | 0.6 | 0.7 | 0.7 |
| **Current account balance (percent of GDP)** | | | | | | | | | | | |
| Current DSA | -2.6 | -1.8 | -4.2 | -4.2 | -4.3 | -4.2 | -4.1 | -3.9 | -3.9 | -3.7 | -3.5 |
| Previous DSA | -2.7 | -1.7 | -3.8 | -3.9 | -4.0 | -3.9 | -3.9 | -3.8 | -3.7 | -3.6 | -3.3 |
| **FDI (percent of GDP)** | | | | | | | | | | | |
| Current DSA | 4.1 | 4.4 | 4.8 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 |
| Previous DSA | 4.5 | 4.2 | 4.4 | 4.2 | 4.2 | 4.3 | 4.3 | 4.3 | 4.4 | 4.5 | 4.7 |

Sources: IMF staff estimates and projections.

- **Real sector.** GDP growth estimates are broadly unchanged with respect to the previous DSA. Compared to the baseline projections in the 2018 DSA, the increased FDI level in 2019 is expected to be maintained over the projection period, supported by the structural reforms implemented during the program. Inflation is projected at about 4 percent, in line with the Central Bank's target.

- **Fiscal variables.**[6] Fiscal projections assume compliance with the FRL, which sets a NFPS deficit limit of 1 percent of GDP from 2019 onwards and a limit to the increase for current spending at the budgetary central government level—which should be below the average real economic growth of the previous 10 years plus the inflation target (leading to about 7 percent in nominal terms). Guided by the FRL deficit target and by an increase in public pension funds' investment in central government debt, the NFPS debt is expected to decrease over the medium-term, as intra public sector financing will be increasing.

- **Debt issuance assumptions.** The share of external borrowing from multilateral and bilateral institutions is expected to remain broadly constant on average over the medium-term. These projections assume that existing Eurobonds will be rolled over, and as a result the grant-element of the overall financing is expected to be lower in the years when Eurobonds are issued (reaching about 20 percent). The share of external financing in total financing is expected to remain constant (at about 75 percent) in the medium-term and to start declining in the long-run (to about 60 percent). The projections also envisage that the authorities succeed in deepening the domestic debt market, increasing maturities and issuing

[6] Historical fiscal figures have changed as a result of data revisions and progressive consolidation of additional government units into the nonfinancial public sector statistics as required by the FRL.

predominantly at fixed rates. These assumptions are consistent with the Honduran Debt Management Strategy.

- **External sector.** In 2018 and 2019, the current account deteriorated as a result of unfavorable terms of trade shocks. The current account deficit is projected to hover around 4 percent of GDP over the medium term; and reach 3½ percent of GDP in the longer term reflecting an improvement in the trade balance as Honduras heightens its competitiveness and penetration of export markets. A decline in external public sector interest payments—as the stock of external debt decreases—explains the lower current account deficits towards the end of the projection period. In the outer years, the current account deficit is expected to be financed primarily by foreign direct investment. This outcome would allow for international reserves to remain above 5 months of non-maquila imports throughout the projection period. FDI is expected to increase in critical economic sectors such as electricity.

**6. The realism tools suggest that the projections are reasonable** (Figures II.3 and II.4).[7,8] The baseline assumes an improvement of the primary balance of 0.5 percentage points of GDP over the next three years, which falls in the third quartile of the distribution for LICs. This improvement in the primary balance is warranted by compliance with the FRL, which serves as an anchor to guide fiscal sustainability. Compared to the previous DSA, both growth projections and the evolution of investment are similar. The projected contribution of the government's capital stock to growth remains in line with the historical levels and the growth path assumes reasonable levels for the fiscal multiplier.

## C. Country Classification

**7. Honduras debt carrying capacity is classified as strong under the revised LIC DSF.** Debt carrying capacity is determined by a composite indicator (CI) that includes the World Bank's Country Policy and Institutional Assessment (CPIA) score, world economic growth, and Honduras's real growth rate, import coverage of reserves, and remittances. Two consecutive signals are needed to modify the classification, which has been the case for Honduras since the implementation of the revised LIC DSF with a CI classification of strong debt carrying capacity in April and October 2018. The current April 2019 vintage also yields a rating of strong debt carrying capacity (Text Table II.4). Under the previous methodology (CPIA-based), Honduras debt carrying capacity was classified as medium (Text Table II.5).

[7] Realism tools are designed to encourage examination of baseline assumptions and cover (i) drivers of debt dynamics, (ii) realism of planned fiscal adjustment, (iii) fiscal adjustment-growth relationship, and (iv) public investment-growth relationship.

[8] Weaknesses in private net foreign assets data could explain in part historical residuals.

**Text Table II.4. Honduras: Calculation of the Composite Indicator**

| Components | Coefficients (A) | 10-year average values (B) | CI Score components (A*B) = (C) | Contribution of components |
|---|---|---|---|---|
| CPIA | 0.385 | 3.482 | 1.34 | 42% |
| Real growth rate (in percent) | 2.719 | 3.676 | 0.10 | 3% |
| Import coverage of reserves (in percent) | 4.052 | 40.340 | 1.63 | 51% |
| Import coverage of reserves^2 (in percent) | -3.990 | 16.273 | -0.65 | -20% |
| Remittances (in percent) | 2.022 | 15.494 | 0.31 | 10% |
| World economic growth (in percent) | 13.520 | 3.559 | 0.48 | 15% |
| CI Score | | | 3.22 | 100% |
| CI rating | | | Strong | |

**Text Table II.5. Honduras: Debt Carrying Capacity Country Classification**

| Final | Classification based on current vintage | Classification based on the October 2018 vintage | Classification based on the April 2018 vintage |
|---|---|---|---|
| Strong | Strong<br>3.22 | Strong<br>3.21 | Strong<br>3.21 |

**8. A strong debt-carrying capacity implies higher thresholds for the stress tests.** For countries classified as having a strong debt carrying capacity, such as Honduras, the corresponding indicative thresholds are the following: 55 percent for the present value (PV) of PPG external debt-to-GDP ratio; 240 percent for the PV of PPG external debt-to-exports ratio; 21 percent for the PPG external debt service-to-exports ratio; and 23 percent for the PPG debt service-to-revenue ratio. The applicable benchmark for total public debt in the case of Honduras is 70 percent for the PV of total public debt-to-GDP ratio (Text Table II.6).

**Text Table II.6. Honduras: Public and Publicly Guaranteed (PPG) External Debt Thresholds and Total Public Debt Benchmarks**

| EXTERNAL debt burden thresholds | Weak | Medium | Strong |
|---|---|---|---|
| PV of debt in % of | | | |
| Exports | 140 | 180 | 240 |
| GDP | 30 | 40 | 55 |
| Debt service in % of | | | |
| Exports | 10 | 15 | 21 |
| Revenue | 14 | 18 | 23 |

| TOTAL public debt benchmark | Weak | Medium | Strong |
|---|---|---|---|
| PV of total public debt in percent of GDP | 35 | 55 | 70 |

## D. External DSA

**9. Honduras's risk of external debt distress is assessed to be low.** The PV of PPG external debt-to-GDP ratio is projected to peak at 27.8 percent in 2019, below the 55 percent threshold (Table II.3). The PPG external debt service-to exports and PPG external debt service-to-revenue peak in 2019, well under their respective thresholds of 21 percent and 23 percent, respectively. Consequently, all solvency and liquidity indicators under the baseline scenario and under various stress tests remain below their respective thresholds (Figure II.1). The peaks observed on debt service indicators are explained by the repayments of Eurobonds (in 2019, 2022, 2026, 2029) and the CABEI bullet repayment in 2025.

**10. However, some debt indicators are sensitive to shocks.** A negative shock to exports, equivalent to a one standard deviation decline in the nominal growth of exports in the second and third years of projection and a decline in real GDP growth, generates the largest increase in the PV of the PPG external debt-to-GDP ratio, leading to a peak of 44.5 percent in 2021 (Figure II.1). Under the same shock, the PPG external debt-to-exports ratio would peak in 2021, reaching 135.4 percent (below the 240 percent threshold). Furthermore, the same shock would lead the PPG external debt-service-to-exports ratio to reach 17.1 percent in 2026, and the PPG external debt-service to revenue ratio to peak at 17.7 in 2026, in both cases well-below the risk thresholds.

**11. Accessing the SBA/SCF arrangements would not jeopardize debt sustainability.** If the SBA/SCF arrangements were to be accessed, the PV of PPG external debt-to-GDP ratio would peak at 28.4 percent in 2020, still below the 55 percent threshold. Similarly, PPG external debt service-to exports and PPG external debt service-to-revenue would peak in 2026 at 11.6 and 14.9, respectively, both well under their respective thresholds. All solvency and liquidity indicators would also remain below their thresholds under all the stress tests.

## E. Public DSA

**12. Public debt ratios are expected to peak in 2019, and then decline over the medium term.** Public debt is projected to peak at 42.1 percent of GDP in 2019 and start declining, supported by stable primary surpluses of around 1 percent of GDP as well as declining interest payments, reaching 36.1 percent of GDP by 2029 (Table II.4 and Figure II.2). The FRL is the critical difference between baseline projections and the historical scenario, providing an anchor for a sound fiscal position. In present value terms, the debt-to-GDP ratio is expected to peak at 37.5 percent of GDP in 2019 and fall to 31.6 percent of GDP by 2029. Public debt dynamics remain somewhat vulnerable to both policy-related and exogenous shocks, especially to those related to fiscal policy and exports (Table II.4). However, under no scenario does any of the indicators breach its benchmark. Thresholds would not be breached either if the SBA/SCF arrangements were to be accessed.

**13. The exposure to contingent liabilities seems to be limited, except for materialization of downside risks facing SOEs.** Upgraded PPP accounting rules to international standards has enabled the impact of PPP operations to be included into the regular public-sector spending and financing recording. In addition, the new contingency unit at the Ministry of Finance (SEFIN) is effectively taking stock of and limiting fiscal exposure from PPPs. The cost of clearing ENEE's growing pending liabilities (estimated at around 1.1 percent of GDP at end-December 2018) is included in the baseline macroeconomic projections through a comprehensive reform program that will include debt refinancing and operational gains. But if this process ends-up being more onerous than currently anticipated it could translate into a negative shock to the PV of public debt.

**14. Market-Financing Risk Indicators suggest potentially low liquidity requirements** (Figure II.5). The maximum gross financing needs over a 3-year period under the baseline projection horizon in Honduras are expected to be around 7 percent of GDP, which is below the benchmark value of 14 percent. In addition, current EMBI spreads of 283 basis points are substantially below the benchmark level of 570 basis points. In addition, the PV of debt relative to GDP and to exports, as well as the ratios of debt service to exports and to revenue, are all expected to remain below the thresholds under the baseline projection and under the market financing scenario. Nevertheless, given significant uncertainty regarding global financial conditions, a cautious debt management approach is warranted.

## F. Conclusion

**15. The DSA indicates that Honduras's risks of external debt and public total debt distress are low, supported by strict observance of the FRL.** This updated risk rating is an improvement from the previous moderate risk rating from the 2018 DSA and reflects also the upgrade in the debt carrying capacity assessment to strong, under the revised DSF methodology. PPG external debt burden indicators remain below the thresholds under the baseline scenario and stress tests. Nonetheless, shocks affecting exports or economic growth showcase existing debt vulnerabilities, implying that adhering consistently to the FRL is a key element to ensuring debt sustainability. The results also highlight the importance of raising domestic revenue, addressing structural vulnerabilities in SOEs, and leveraging concessional sources of financing when available.

***Authorities' Views***

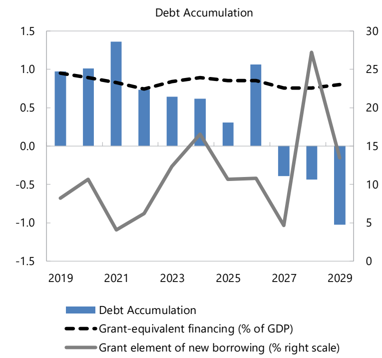
**16. Authorities agreed with the change in the risk rating following the application of the revised LIC DSF.** They noted their commitment to adhere to the FRL, preserving the revenue mobilization efforts while implementing reforms in SOEs to resolve their imbalances, and to the further development of the domestic debt market. The contingency unit at SEFIN will continue addressing data limitations with the goal of improving the management of fiscal risks.

# Table II.1. Honduras: External Debt Sustainability Framework, Baseline Scenario, 2016-39

(In percent of GDP, unless otherwise indicated)

| | Actual | | | Projections | | | | | | | | Average 8/ | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 | 2039 | Historical | Projections |
| **External debt (nominal) 1/** | 35.4 | 37.2 | 38.5 | 38.0 | 37.8 | 37.8 | 37.1 | 36.5 | 35.8 | 28.9 | 19.4 | **31.7** | **35.0** |
| ***of which: public and publicly guaranteed (PPG)*** | 28.9 | 31.1 | 31.6 | 31.7 | 31.5 | 31.5 | 30.8 | 30.2 | 29.5 | 22.7 | 13.1 | **25.0** | **28.7** |
| | | | | | | | | | | | | | |
| Change in external debt | -0.7 | 1.9 | 1.2 | -0.5 | -0.2 | 0.0 | -0.6 | -0.7 | -0.7 | -2.2 | -0.6 | | |
| **Identified net debt-creating flows** | -2.7 | -4.7 | -1.6 | -2.1 | -2.0 | -1.8 | -1.8 | -2.0 | -2.0 | -2.0 | -2.1 | **-1.1** | **-2.0** |
| **Non-interest current account deficit** | 2.1 | 1.2 | 3.2 | 2.7 | 2.7 | 3.0 | 2.9 | 2.7 | 2.8 | 2.7 | 2.8 | **4.9** | **2.8** |
| Deficit in balance of goods and services | 14.2 | 14.1 | 18.3 | 17.4 | 17.5 | 17.8 | 17.8 | 18.0 | 18.1 | 17.9 | 18.1 | **17.6** | **17.9** |
| Exports | 42.4 | 43.1 | 42.1 | 41.7 | 42.2 | 42.3 | 42.3 | 42.5 | 42.3 | 41.9 | 42.3 | | |
| Imports | 56.6 | 57.3 | 60.3 | 59.2 | 59.7 | 60.1 | 60.1 | 60.5 | 60.4 | 59.8 | 60.4 | | |
| Net current transfers (negative = inflow) | -18.4 | -19.5 | -20.7 | -20.3 | -20.3 | -20.2 | -20.2 | -20.3 | -20.2 | -19.9 | -20.1 | **-18.6** | **-20.1** |
| *of which: official* | -0.3 | -0.3 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 | | |
| Other current account flows (negative = net inflow) | 6.3 | 6.5 | 5.7 | 5.6 | 5.5 | 5.5 | 5.3 | 5.0 | 4.9 | 4.7 | 4.8 | **5.9** | **5.0** |
| **Net FDI (negative = inflow)** | -4.1 | -4.4 | -4.8 | -4.7 | -4.7 | -4.7 | -4.7 | -4.7 | -4.7 | -4.7 | -4.7 | **-5.0** | **-4.7** |
| **Endogenous debt dynamics 2/** | -0.6 | -1.5 | 0.0 | -0.1 | 0.0 | -0.1 | 0.0 | -0.1 | -0.1 | 0.0 | -0.1 | | |
| Contribution from nominal interest rate | 0.6 | 0.6 | 1.1 | 1.2 | 1.3 | 1.2 | 1.3 | 1.3 | 1.2 | 1.1 | 0.6 | | |
| Contribution from real GDP growth | -1.3 | -1.6 | -1.3 | -1.3 | -1.3 | -1.3 | -1.3 | -1.3 | -1.4 | -1.2 | -0.7 | | |
| Contribution from price and exchange rate changes | 0.1 | -0.5 | 0.3 | ... | ... | ... | ... | ... | ... | ... | ... | | |
| **Residual 3/** | 1.9 | 6.6 | 2.9 | 1.6 | 1.8 | 1.7 | 1.2 | 1.4 | 1.4 | -0.2 | 1.5 | **2.4** | **1.1** |
| *of which: exceptional financing* | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| | | | | | | | | | | | | | |
| **Sustainability indicators** | | | | | | | | | | | | | |
| **PV of PPG external debt-to-GDP ratio** | ... | ... | 22.2 | 22.3 | 22.5 | 22.9 | 22.6 | 22.3 | 21.9 | 16.7 | 9.0 | | |
| **PV of PPG external debt-to-exports ratio** | ... | ... | 52.8 | 53.5 | 53.3 | 54.0 | 53.5 | 52.5 | 51.7 | 39.8 | 21.2 | | |
| **PPG debt service-to-exports ratio** | 8.4 | 8.8 | 4.8 | 9.5 | 4.8 | 8.8 | 4.8 | 4.6 | 4.4 | 7.2 | 2.5 | | |
| **PPG debt service-to-revenue ratio** | 12.0 | 12.7 | 6.7 | 13.4 | 6.6 | 12.2 | 6.5 | 6.2 | 5.9 | 9.5 | 3.3 | | |
| Gross external financing need (Billion of U.S. dollars) | 1.4 | 1.8 | 2.1 | 2.6 | 1.6 | 2.2 | 1.7 | 1.6 | 1.6 | 2.1 | 2.0 | | |
| | | | | | | | | | | | | | |
| **Key macroeconomic assumptions** | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 3.8 | 4.9 | 3.7 | 3.5 | 3.6 | 3.6 | 3.7 | 3.8 | 3.9 | 3.9 | 3.9 | **3.1** | **3.8** |
| GDP deflator in US dollar terms (change in percent) | -0.2 | 1.4 | -0.7 | 0.3 | 0.3 | 0.7 | 0.6 | 0.7 | 0.7 | 1.0 | 1.2 | **2.5** | **0.7** |
| Effective interest rate (percent) 4/ | 1.7 | 1.8 | 3.0 | 3.2 | 3.7 | 3.3 | 3.7 | 3.6 | 3.5 | 3.8 | 3.2 | **1.9** | **3.6** |
| Growth of exports of G&S (US dollar terms, in percent) | -2.4 | 8.2 | 0.4 | 3.0 | 4.9 | 4.7 | 4.3 | 4.8 | 4.4 | 4.6 | 5.2 | **4.2** | **4.5** |
| Growth of imports of G&S (US dollar terms, in percent) | -4.2 | 7.6 | 8.4 | 1.8 | 4.8 | 5.1 | 4.2 | 5.1 | 4.6 | 4.6 | 5.2 | **3.1** | **4.4** |
| Grant element of new public sector borrowing (in percent) | ... | ... | ... | 8.2 | 10.7 | 4.1 | 6.2 | 12.4 | 16.5 | 13.4 | 20.5 | **...** | **11.3** |
| Government revenues (excluding grants, in percent of GDP) | 29.6 | 29.7 | 29.7 | 29.5 | 30.3 | 30.7 | 30.9 | 31.3 | 31.3 | 31.5 | 32.0 | **28.2** | **31.0** |
| Aid flows (in Billion of US dollars) 5/ | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.5 | | |
| Grant-equivalent financing (in percent of GDP) 6/ | ... | ... | ... | 0.9 | 0.9 | 0.8 | 0.7 | 0.8 | 0.9 | 0.8 | 0.8 | **...** | **0.8** |
| Grant-equivalent financing (in percent of external financing) 6/ | ... | ... | ... | 19.9 | 32.4 | 17.4 | 32.8 | 38.0 | 41.4 | 44.5 | 57.0 | **...** | **35.3** |
| Nominal GDP (Billion of US dollars) | 22 | 23 | 24 | 25 | 26 | 27 | 28 | 29 | 30 | 39 | 64 | | |
| Nominal dollar GDP growth | 3.5 | 6.4 | 2.9 | 3.8 | 3.8 | 4.4 | 4.3 | 4.5 | 4.6 | 5.0 | 5.2 | **5.6** | **4.5** |
| | | | | | | | | | | | | | |
| **Memorandum items:** | | | | | | | | | | | | | |
| PV of external debt 7/ | ... | ... | 29.1 | 28.6 | 28.8 | 29.2 | 28.9 | 28.6 | 28.2 | 22.9 | 15.3 | | |
| In percent of exports | ... | ... | 69.2 | 68.6 | 68.2 | 68.9 | 68.4 | 67.3 | 66.5 | 54.7 | 36.0 | | |
| Total external debt service-to-exports ratio | 20.2 | 25.6 | 25.3 | 30.2 | 19.8 | 23.5 | 18.8 | 17.8 | 16.9 | 17.9 | 12.0 | | |
| PV of PPG external debt (in Billion of US dollars) | | | 5.3 | 5.5 | 5.8 | 6.1 | 6.3 | 6.5 | 6.7 | 6.4 | 5.7 | | |
| (PVt-PVt-1)/GDPt-1 (in percent) | | | | 1.0 | 1.0 | 1.4 | 0.7 | 0.6 | 0.6 | -1.0 | 0.0 | | |
| Non-interest current account deficit that stabilizes debt ratio | 2.8 | -0.7 | 1.9 | 3.2 | 2.9 | 3.1 | 3.6 | 3.4 | 3.5 | 4.8 | 3.3 | | |

| **Definition of external/domestic debt** | **Currency-based** |
|---|---|
| **Is there a material difference between the two criteria?** | **No** |





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

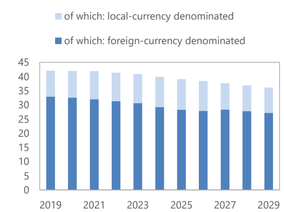
# Table II.2. Honduras: Public Debt Sustainability Framework, Baseline Scenario, 2016-39

(In percent of GDP, unless otherwise indicated)

| | Actual | | | Projections | | | | | | | | Average 6/ | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 | 2039 | Historical | Projections |
| **Public sector debt 1/** | **39.9** | **39.9** | **41.8** | **42.1** | **42.0** | **41.9** | **41.4** | **40.9** | **39.9** | **36.1** | **31.3** | **33.9** | **39.7** |
| **of which: external debt** | **28.4** | **30.5** | **31.0** | **32.9** | **32.6** | **32.0** | **31.3** | **30.6** | **29.3** | **27.2** | **18.8** | **24.4** | **29.9** |
| Change in public sector debt | 0.8 | 0.1 | 1.9 | 0.3 | -0.1 | -0.1 | -0.5 | -0.5 | -1.0 | -0.8 | -0.3 | | |
| **Identified debt-creating flows** | **0.1** | **-1.9** | **1.1** | **0.3** | **-0.1** | **0.0** | **-0.4** | **-0.2** | **-0.5** | **-0.7** | **-0.3** | **2.0** | **-0.4** |
| **Primary deficit** | **-0.3** | **-0.1** | **0.0** | **-0.6** | **-0.7** | **-0.8** | **-1.0** | **-0.9** | **-0.7** | **-0.7** | **-0.5** | **2.7** | **-0.8** |
| Revenue and grants | 30.4 | 30.3 | 30.1 | 30.9 | 31.3 | 31.7 | 31.8 | 31.9 | 31.9 | 32.4 | 32.9 | **29.2** | **31.9** |
| *of which: grants* | 0.8 | 0.6 | 0.7 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | | |
| Primary (noninterest) expenditure | 30.1 | 30.2 | 30.0 | 30.3 | 30.6 | 30.9 | 30.8 | 31.0 | 31.2 | 31.7 | 32.4 | **31.8** | **31.1** |
| **Automatic debt dynamics** | **0.9** | **-1.4** | **1.5** | **0.9** | **0.4** | **0.4** | **0.3** | **0.4** | **0.3** | **0.1** | **0.2** | | |
| Contribution from interest rate/growth differential | 0.2 | -0.9 | 0.2 | 0.1 | -0.1 | -0.1 | -0.1 | 0.0 | 0.0 | -0.1 | 0.0 | | |
| *of which: contribution from average real interest rate* | 1.6 | 0.9 | 1.6 | 1.5 | 1.3 | 1.4 | 1.4 | 1.5 | 1.5 | 1.3 | 1.2 | | |
| *of which: contribution from real GDP growth* | -1.4 | -1.9 | -1.4 | -1.4 | -1.4 | -1.5 | -1.5 | -1.5 | -1.6 | -1.4 | -1.2 | | |
| Contribution from real exchange rate depreciation | 0.6 | -0.5 | 1.3 | ... | ... | ... | ... | ... | ... | ... | ... | | |
| **Other identified debt-creating flows** | **-0.4** | **-0.4** | **-0.4** | **-0.1** | **0.2** | **0.4** | **0.3** | **0.3** | **-0.2** | **-0.1** | **0.0** | **-0.2** | **0.0** |
| Privatization receipts (negative) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Recognition of contingent liabilities (e.g., bank recapitalization) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |
| Debt relief (HIPC and other) | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.3 | -0.3 | -0.3 | -0.1 | 0.0 | | |
| Other debt creating or reducing flow (please specify) | 0.0 | 0.0 | 0.0 | 0.3 | 0.6 | 0.8 | 0.7 | 0.6 | 0.1 | 0.0 | 0.0 | | |
| **Residual** | **0.7** | **2.0** | **0.8** | **0.8** | **0.5** | **0.3** | **0.3** | **0.1** | **-0.1** | **0.2** | **0.1** | **0.7** | **0.3** |
| **Sustainability indicators** | | | | | | | | | | | | | |
| **PV of public debt-to-GDP ratio 2/** | **...** | **...** | **37.3** | **37.5** | **37.4** | **37.2** | **36.8** | **36.2** | **35.2** | **31.6** | **28.3** | | |
| **PV of public debt-to-revenue and grants ratio** | **...** | **...** | **124.1** | **121.1** | **119.3** | **117.7** | **115.7** | **113.5** | **110.4** | **97.6** | **86.1** | | |
| **Debt service-to-revenue and grants ratio 3/** | **10.2** | **10.4** | **11.6** | **24.3** | **16.5** | **17.3** | **24.6** | **18.7** | **19.0** | **22.4** | **21.4** | | |
| Gross financing need 4/ | 2.4 | 2.7 | 3.1 | 6.9 | 4.7 | 5.1 | 7.1 | 5.4 | 5.2 | 6.4 | 6.5 | | |
| **Key macroeconomic and fiscal assumptions** | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 3.8 | 4.9 | 3.7 | 3.4 | 3.5 | 3.6 | 3.7 | 3.9 | 3.9 | 3.9 | 3.9 | **3.1** | **3.8** |
| Average nominal interest rate on external debt (in percent) | 1.9 | 2.0 | 3.4 | 4.2 | 4.3 | 4.3 | 4.5 | 4.8 | 4.7 | 4.5 | 4.8 | **2.0** | **4.6** |
| Average real interest rate on domestic debt (in percent) | 13.4 | 8.4 | 14.5 | 7.1 | 7.1 | 7.7 | 7.2 | 7.6 | 7.7 | 7.1 | 6.1 | **4.1** | **7.3** |
| Real exchange rate depreciation (in percent, + indicates depreciation) | 2.3 | -1.9 | 4.3 | ... | ... | ... | ... | ... | ... | ... | ... | **-0.6** | **...** |
| Inflation rate (GDP deflator, in percent) | 3.8 | 4.3 | 1.8 | 3.2 | 3.4 | 3.2 | 3.5 | 3.6 | 3.8 | 4.1 | 4.0 | **4.9** | **3.7** |
| Growth of real primary spending (deflated by GDP deflator, in percent) | 5.2 | 5.6 | 3.0 | 4.4 | 4.5 | 4.4 | 3.4 | 4.7 | 4.7 | 4.3 | 4.0 | **2.3** | **4.3** |
| Primary deficit that stabilizes the debt-to-GDP ratio 5/ | -1.2 | -0.2 | -1.9 | -0.9 | -0.6 | -0.7 | -0.5 | -0.4 | 0.4 | 0.1 | -0.2 | **-1.1** | **-0.3** |
| PV of contingent liabilities (not included in public sector debt) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | |

| | |
|---|---|
| **Definition of external/domestic debt** | **Currency-based** |
| **Is there a material difference between the two criteria?** | **No** |

Public sector debt 1/




Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The general government, government-guaranteed debt, non-guaranteed SOE debt . Definition of external debt is Currency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

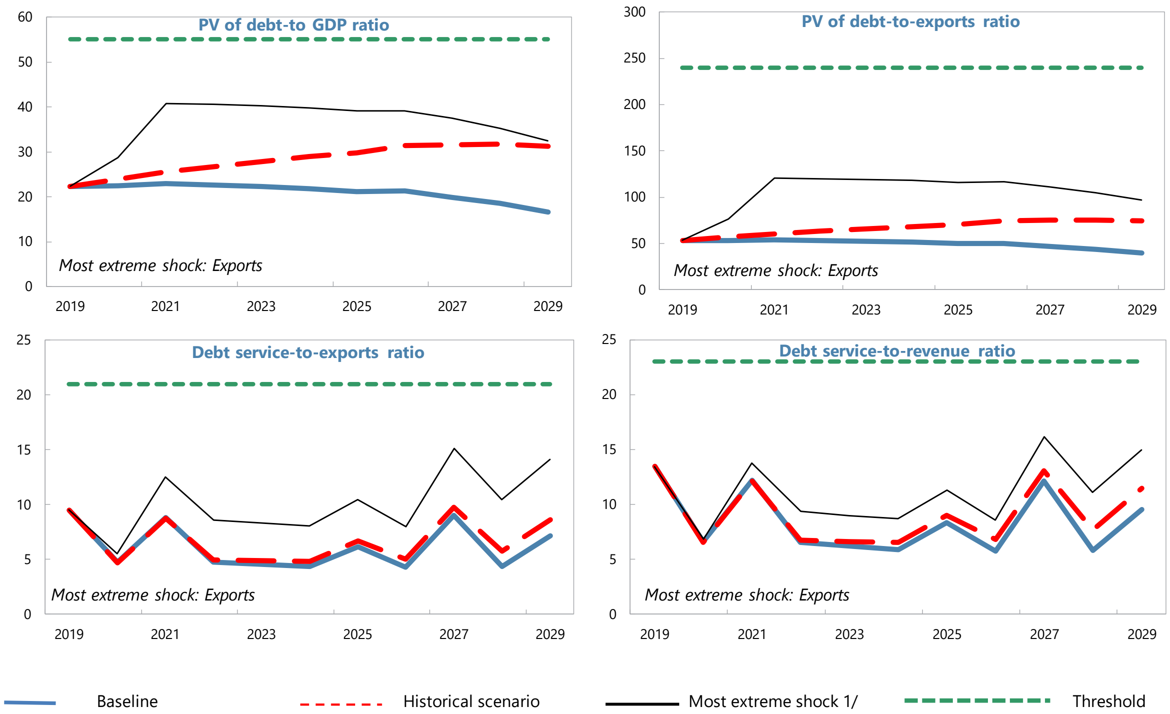
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

## Figure II.1. Honduras: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2019-29




| Customization of Default Settings | Size | Interactions |
|---|---|---|
| **Tailored Stress** | | |
| Combined CL | No | |
| Natural disaster | No | No |
| Commodity price | n.a. | n.a. |
| Market financing | No | No |

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

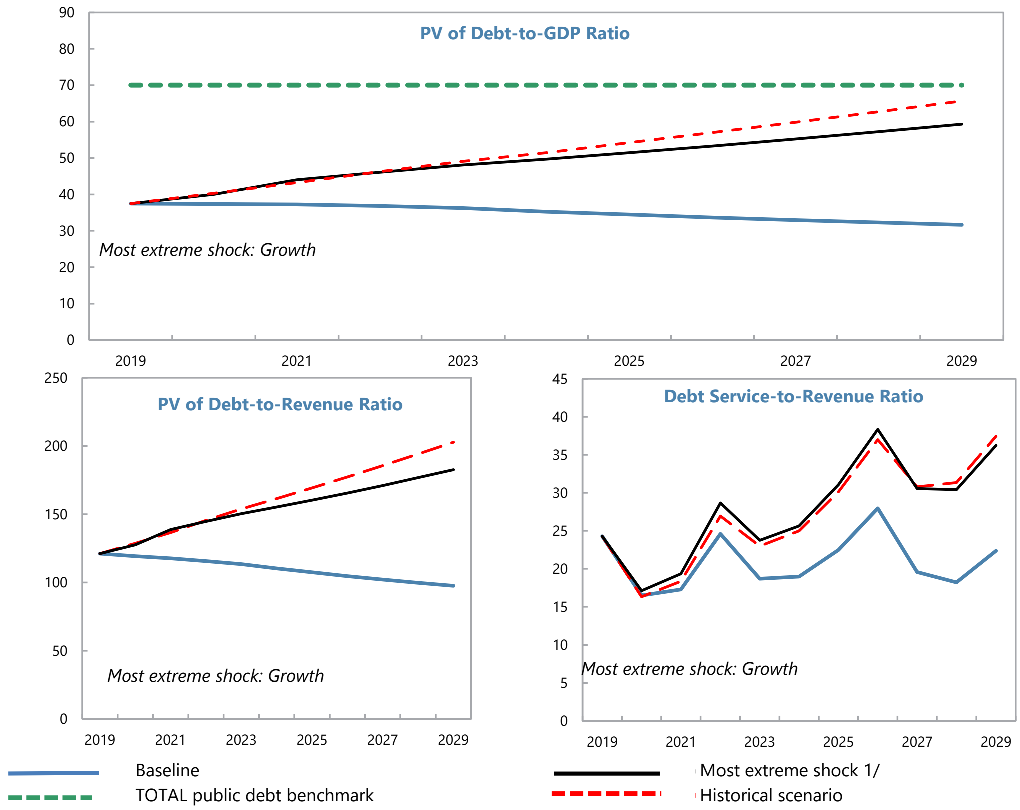
| Borrowing assumptions on additional financing needs resulting from the stress tests* | Default | User defined |
|---|---|---|
| **Shares of marginal debt** | | |
| External PPG MLT debt | 100% | |
| **Terms of marginal debt** | | |
| Avg. nominal interest rate on new borrowing in USD | 4.7% | 4.7% |
| USD Discount rate | 5.0% | 5.0% |
| Avg. maturity (incl. grace period) | 21 | 21 |
| Avg. grace period | 6 | 6 |

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

## Figure II.2. Honduras: Indicators of Public Debt under Alternative Scenarios, 2019-29




| Borrowing assumptions on additional financing needs resulting from the stress tests* | Default | User defined |
|---|---|---|
| **Shares of marginal debt** | | |
| **External PPG medium and long-term** | 45% | 45% |
| **Domestic medium and long-term** | 54% | 54% |
| **Domestic short-term** | 0% | 0% |
| **Terms of marginal debt** | | |
| **External MLT debt** | | |
| **Avg. nominal interest rate on new borrowing in USD** | 5.1% | 5.1% |
| **Avg. maturity (incl. grace period)** | 20 | 20 |
| **Avg. grace period** | 6 | 6 |
| **Domestic MLT debt** | | |
| **Avg. real interest rate on new borrowing** | 6.7% | 6.7% |
| **Avg. maturity (incl. grace period)** | 5 | 5 |
| **Avg. grace period** | 0 | 0 |
| **Domestic short-term debt** | | |
| **Avg. real interest rate** | 0.0% | 0.0% |

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

## Table II.3. Honduras: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019-29

(In percent)

| | Projections 1/ | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 |
| **PV of debt-to GDP ratio** | | | | | | | | | | | |
| **Baseline** | 28 | 28 | 27 | 26 | 26 | 24 | 23 | 23 | 23 | 23 | 22 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 28 | 29 | 30 | 32 | 33 | 34 | 35 | 37 | 40 | 42 | 43 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 28 | 29 | 29 | 28 | 28 | 26 | 25 | 25 | 25 | 25 | 24 |
| B2. Primary balance | 28 | 30 | 35 | 35 | 35 | 34 | 34 | 34 | 35 | 35 | 34 |
| B3. Exports | 28 | 34 | 44 | 44 | 43 | 42 | 41 | 40 | 41 | 39 | 38 |
| B4. Other flows 3/ | 28 | 33 | 38 | 37 | 36 | 35 | 34 | 34 | 34 | 33 | 32 |
| B5. Depreciation | 28 | 35 | 26 | 25 | 24 | 23 | 22 | 21 | 22 | 21 | 21 |
| B6. Combination of B1-B5 | 28 | 38 | 42 | 41 | 41 | 39 | 38 | 38 | 38 | 37 | 35 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 28 | 34 | 34 | 35 | 35 | 34 | 34 | 34 | 35 | 35 | 35 |
| C2. Natural disaster | 28 | 33 | 33 | 33 | 33 | 33 | 33 | 33 | 34 | 35 | 35 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 28 | 31 | 30 | 29 | 29 | 27 | 26 | 26 | 26 | 26 | 25 |
| **Threshold** | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 | 55 |
| **PV of debt-to-exports ratio** | | | | | | | | | | | |
| **Baseline** | 68 | 68 | 66 | 65 | 63 | 60 | 58 | 56 | 58 | 57 | 55 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 68 | 72 | 74 | 77 | 81 | 84 | 88 | 92 | 99 | 103 | 107 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 68 | 68 | 66 | 65 | 63 | 60 | 58 | 56 | 58 | 57 | 55 |
| B2. Primary balance | 68 | 74 | 86 | 86 | 86 | 85 | 84 | 84 | 87 | 86 | 85 |
| B3. Exports | 68 | 92 | 135 | 133 | 131 | 128 | 125 | 123 | 124 | 120 | 116 |
| B4. Other flows 3/ | 68 | 81 | 93 | 91 | 89 | 87 | 84 | 83 | 84 | 81 | 79 |
| B5. Depreciation | 68 | 68 | 51 | 49 | 47 | 44 | 42 | 41 | 42 | 42 | 42 |
| B6. Combination of B1-B5 | 68 | 94 | 95 | 106 | 105 | 102 | 99 | 98 | 98 | 95 | 92 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 68 | 84 | 84 | 85 | 85 | 85 | 85 | 84 | 87 | 87 | 86 |
| C2. Natural disaster | 68 | 82 | 83 | 83 | 83 | 83 | 83 | 84 | 87 | 87 | 87 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 68 | 68 | 66 | 65 | 63 | 61 | 58 | 57 | 59 | 57 | 56 |
| **Threshold** | 240 | 240 | 240 | 240 | 240 | 240 | 240 | 240 | 240 | 240 | 240 |
| **Debt service-to-exports ratio** | | | | | | | | | | | |
| **Baseline** | 11 | 6 | 6 | 10 | 6 | 6 | 8 | 11 | 5 | 6 | 9 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 11 | 6 | 6 | 10 | 6 | 7 | 9 | 12 | 7 | 8 | 12 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 11 | 6 | 6 | 10 | 6 | 6 | 8 | 11 | 5 | 6 | 9 |
| B2. Primary balance | 11 | 6 | 6 | 12 | 7 | 7 | 9 | 13 | 7 | 8 | 12 |
| B3. Exports | 11 | 7 | 9 | 16 | 10 | 10 | 13 | 17 | 10 | 12 | 17 |
| B4. Other flows 3/ | 11 | 6 | 7 | 12 | 7 | 7 | 9 | 12 | 7 | 8 | 12 |
| B5. Depreciation | 11 | 6 | 6 | 10 | 5 | 5 | 7 | 10 | 5 | 4 | 8 |
| B6. Combination of B1-B5 | 11 | 6 | 8 | 13 | 8 | 8 | 11 | 14 | 9 | 10 | 14 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 11 | 6 | 7 | 11 | 7 | 7 | 9 | 12 | 7 | 7 | 11 |
| C2. Natural disaster | 11 | 6 | 7 | 11 | 7 | 7 | 9 | 13 | 7 | 7 | 11 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 11 | 6 | 6 | 10 | 6 | 6 | 9 | 12 | 10 | 5 | 9 |
| **Threshold** | 21 | 21 | 21 | 21 | 21 | 21 | 21 | 21 | 21 | 21 | 21 |
| **Debt service-to-revenue ratio** | | | | | | | | | | | |
| **Baseline** | 14 | 8 | 8 | 14 | 8 | 8 | 10 | 14 | 7 | 7 | 12 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 14 | 8 | 8 | 14 | 8 | 9 | 11 | 15 | 9 | 10 | 15 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 14 | 8 | 8 | 15 | 8 | 8 | 11 | 16 | 8 | 8 | 13 |
| B2. Primary balance | 14 | 8 | 8 | 15 | 10 | 9 | 12 | 16 | 9 | 10 | 15 |
| B3. Exports | 14 | 8 | 9 | 17 | 11 | 11 | 13 | 18 | 11 | 12 | 17 |
| B4. Other flows 3/ | 14 | 8 | 9 | 15 | 9 | 9 | 12 | 16 | 9 | 10 | 15 |
| B5. Depreciation | 14 | 10 | 10 | 16 | 9 | 8 | 12 | 17 | 8 | 6 | 12 |
| B6. Combination of B1-B5 | 14 | 8 | 10 | 17 | 11 | 10 | 13 | 18 | 11 | 12 | 17 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 14 | 8 | 9 | 15 | 9 | 9 | 12 | 16 | 9 | 9 | 14 |
| C2. Natural disaster | 14 | 8 | 8 | 14 | 9 | 9 | 11 | 16 | 8 | 9 | 13 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 14 | 8 | 8 | 14 | 8 | 8 | 11 | 15 | 12 | 7 | 11 |
| **Threshold** | 23 | 23 | 23 | 23 | 23 | 23 | 23 | 23 | 23 | 23 | 23 |

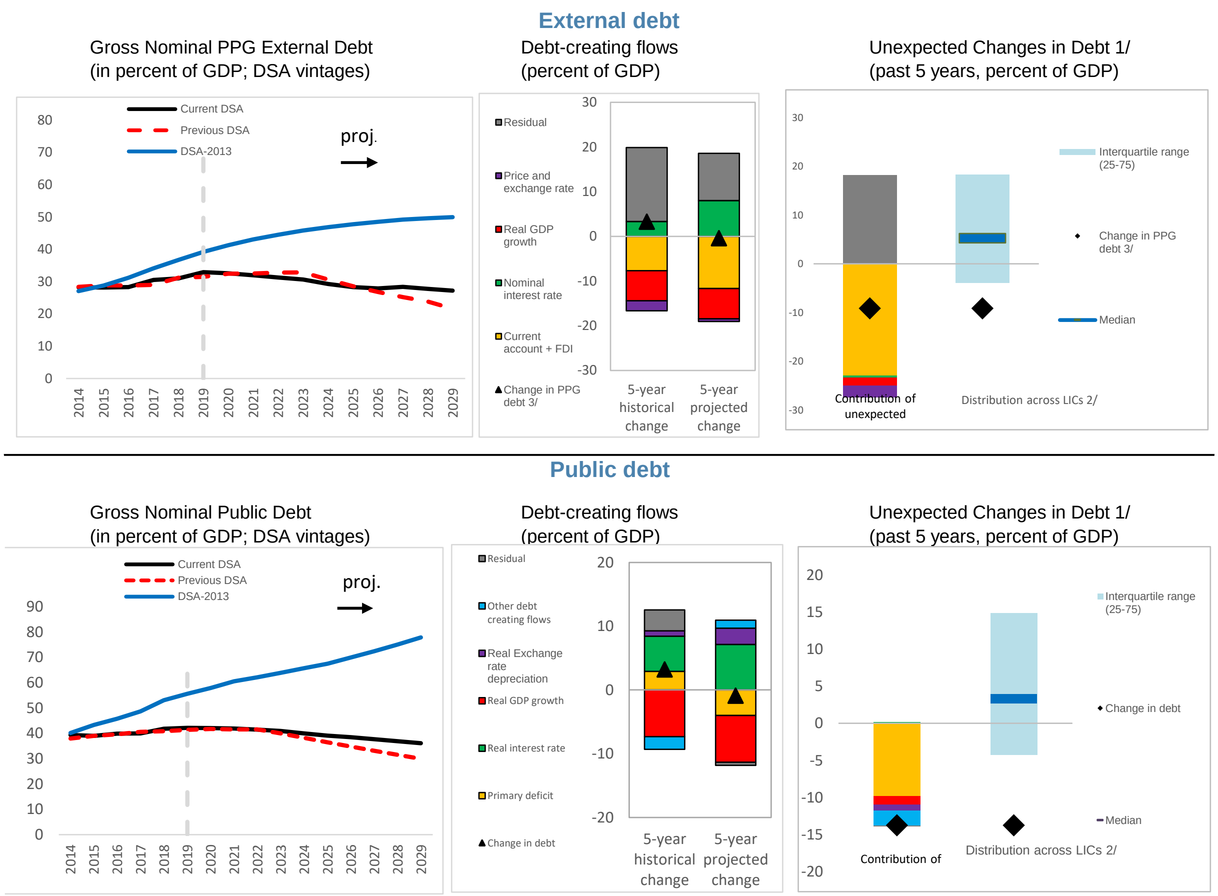
Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

## Table II.4. Honduras: Sensitivity Analysis for Key Indicators of Public Debt, 2019-29

| | Projections 1/ | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2027** | **2028** | **2029** |
| | | | | | **PV of Debt-to-GDP Ratio** | | | | | | |
| **Baseline** | 37 | 37 | 37 | 37 | 36 | 35 | 34 | 34 | 33 | 32 | 32 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 37 | 40 | 43 | 46 | 49 | 51 | 54 | 57 | 60 | 63 | 66 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 37 | 40 | 44 | 46 | 48 | 50 | 51 | 53 | 55 | 57 | 59 |
| B2. Primary balance | 37 | 43 | 52 | 52 | 51 | 50 | 50 | 49 | 49 | 48 | 47 |
| B3. Exports | 37 | 43 | 52 | 52 | 52 | 51 | 50 | 49 | 48 | 47 | 45 |
| B4. Other flows 3/ | 37 | 43 | 48 | 48 | 47 | 46 | 45 | 45 | 44 | 42 | 41 |
| B5. Depreciation | 37 | 42 | 40 | 37 | 34 | 30 | 27 | 24 | 20 | 17 | 14 |
| B6. Combination of B1-B5 | 37 | 41 | 47 | 46 | 46 | 45 | 44 | 43 | 42 | 42 | 41 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 37 | 52 | 52 | 52 | 51 | 50 | 50 | 49 | 48 | 48 | 47 |
| C2. Natural disaster | 37 | 48 | 49 | 49 | 49 | 49 | 48 | 48 | 48 | 48 | 48 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 37 | 37 | 37 | 37 | 36 | 35 | 35 | 34 | 33 | 32 | 32 |
| **TOTAL public debt benchmark** | 70 | 70 | 70 | 70 | 70 | 70 | 70 | 70 | 70 | 70 | 70 |
| | | | | | **PV of Debt-to-Revenue Ratio** | | | | | | |
| **Baseline** | 121 | 119 | 118 | 116 | 113 | 110 | 108 | 105 | 102 | 100 | 98 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 121 | 129 | 137 | 146 | 154 | 161 | 169 | 177 | 186 | 194 | 203 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 121 | 128 | 139 | 145 | 150 | 155 | 160 | 166 | 171 | 177 | 183 |
| B2. Primary balance | 121 | 138 | 164 | 162 | 161 | 158 | 156 | 153 | 151 | 148 | 146 |
| B3. Exports | 121 | 136 | 166 | 164 | 161 | 158 | 155 | 152 | 149 | 144 | 139 |
| B4. Other flows 3/ | 121 | 137 | 152 | 150 | 148 | 145 | 142 | 139 | 135 | 131 | 127 |
| B5. Depreciation | 121 | 136 | 126 | 116 | 106 | 95 | 84 | 74 | 63 | 54 | 44 |
| B6. Combination of B1-B5 | 121 | 131 | 147 | 145 | 143 | 140 | 137 | 134 | 132 | 129 | 126 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 121 | 165 | 164 | 162 | 160 | 158 | 155 | 153 | 150 | 148 | 146 |
| C2. Natural disaster | 121 | 154 | 154 | 154 | 154 | 153 | 151 | 150 | 149 | 148 | 148 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 121 | 119 | 118 | 116 | 114 | 111 | 108 | 106 | 103 | 100 | 98 |
| | | | | | **Debt Service-to-Revenue Ratio** | | | | | | |
| **Baseline** | 24 | 16 | 17 | 25 | 19 | 19 | 22 | 28 | 20 | 18 | 22 |
| **A. Alternative Scenarios** | | | | | | | | | | | |
| A1. Key variables at their historical averages in 2019-2029 2/ | 24 | 16 | 18 | 27 | 23 | 25 | 30 | 37 | 31 | 31 | 37 |
| **B. Bound Tests** | | | | | | | | | | | |
| B1. Real GDP growth | 24 | 17 | 19 | 29 | 24 | 26 | 31 | 38 | 31 | 30 | 36 |
| B2. Primary balance | 24 | 16 | 21 | 33 | 27 | 28 | 32 | 36 | 27 | 26 | 30 |
| B3. Exports | 24 | 16 | 18 | 27 | 21 | 21 | 25 | 30 | 23 | 23 | 27 |
| B4. Other flows 3/ | 24 | 16 | 18 | 26 | 20 | 21 | 24 | 30 | 22 | 21 | 26 |
| B5. Depreciation | 24 | 17 | 18 | 26 | 18 | 18 | 22 | 28 | 18 | 16 | 21 |
| B6. Combination of B1-B5 | 24 | 16 | 19 | 28 | 23 | 23 | 26 | 32 | 23 | 21 | 25 |
| **C. Tailored Tests** | | | | | | | | | | | |
| C1. Combined contingent liabilities | 24 | 16 | 25 | 33 | 27 | 28 | 32 | 35 | 26 | 25 | 28 |
| C2. Natural disaster | 24 | 17 | 23 | 31 | 26 | 27 | 31 | 35 | 26 | 25 | 29 |
| C3. Commodity price | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C4. Market Financing | 24 | 16 | 17 | 25 | 19 | 20 | 23 | 29 | 25 | 18 | 22 |

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

### Figure II.3. Honduras: Drivers of Debt Dynamics – Baseline Scenario



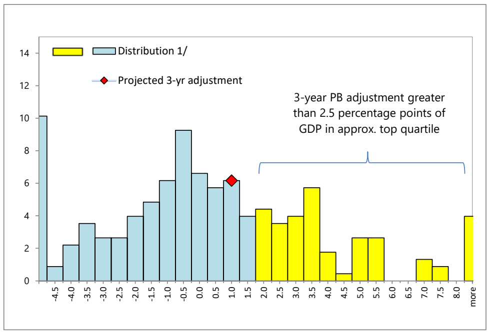

1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

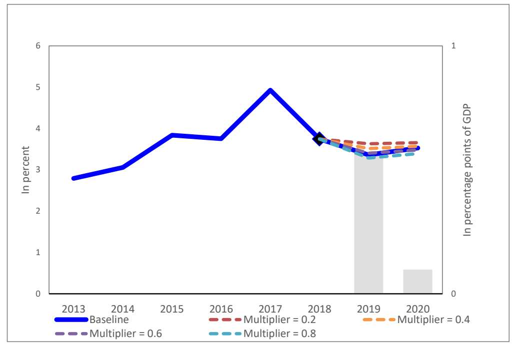
## Figure II.4. Honduras: Realism Tools

**3-Year Adjustment in Primary Balance**
**(Percentage points of GDP)**



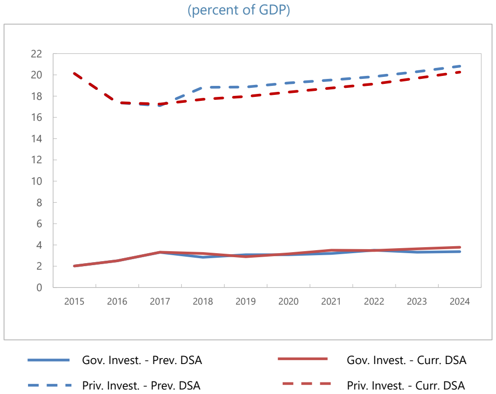

1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

**Fiscal Adjustment and Possible Growth Paths 1/**

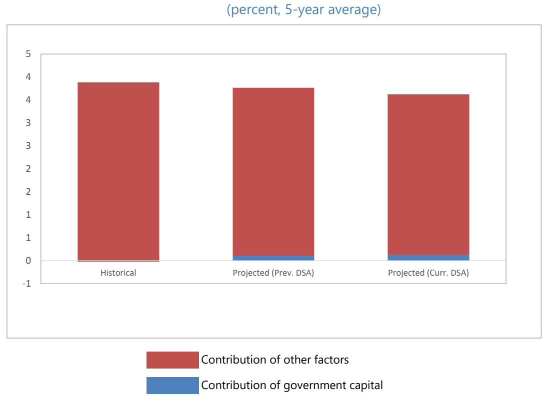



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

**Public and Private Investment Rates**
(percent of GDP)



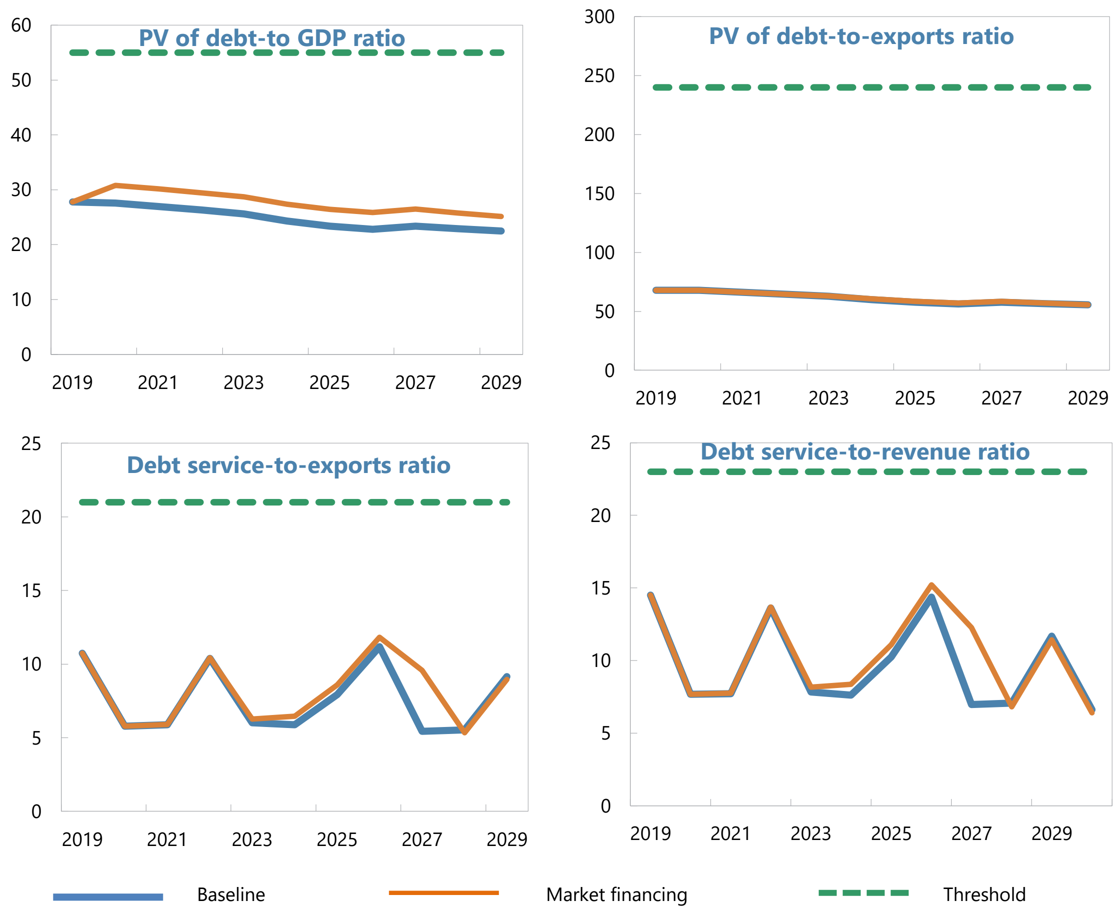

**Contribution to Real GDP growth**
(percent, 5-year average)



## Figure II.5. Honduras: Market-Financing Risk Indicators

| | GFN 1/ | EMBI 2/ |
|---|---|---|
| Benchmarks | 14 | 570 |
| Values | 7 | 283 |
| Breach of benchmark | No | No |
| Potential heightened liquidity needs | Low | |

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.




Sources: Country authorities; and staff estimates and projections.

# Annex III. Risk Assessment Matrix[1]

| Source | Relative likelihood | Expected Impact | Policy Response |
|---|---|---|---|
| **External Risks** | | | |
| **Rising protectionism and retreat from multilateralism.** | High | Honduras' open economy is vulnerable to changes in trade policies (particularly in the U.S., its main trade partner and foreign investor). A reduction in FDI flows and remittances could trigger an adjustment in the current account with a large impact on economic activity and international reserves. | Increase exchange rate flexibility to buffer the shock and speed up structural reforms to strengthen competitiveness. Tighten monetary policy to protect reserve position. |
| **Weaker-than-expected global growth** | Medium | Weaker-than-expected growth in large economies, particularly in the U.S., could lower exports demand, remittances (and consumption), and foreign investment flows, weakening economic activity. | Ease monetary policy while ensuring that inflation expectations remain anchored. Increase exchange rate flexibility. |
| **Large swings in energy prices** | Medium | Risks to oil prices are balanced due to large and uncertain supply and demand shocks. If oil prices rise, it could impact inflation and the external position; and deteriorate ENEE fragile finances if higher costs are not promptly transferred to tariffs. | Ensure that swings in oil prices are immediately transferred to electricity tariffs. Use monetary policy to moderate inflation expectations. |
| **Sharp tightening of global financial conditions** | Low | Higher interest rates would increase debt service and refinancing risks; possible balance sheet effects in unhedged FX firms and households. Capital flow reversals to trigger pressures on the international reserves position. | Debt management operations (pre-financing if feasible) to minimize exchange rate risks. Increase exchange rate flexibility and monetary tightening. |
| **Internal Risks** | | | |
| **Large social disruptions** | Medium | Weak social conditions and widespread gang violence could accelerate migrant flows. Potential for U.S. aid withdrawal. | Strengthen social and security policies. |

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

# Annex IV. Financial Sector Stability Review Main Recommendations[1]

| Key Recommendations | Recommended Timeframe/Current Status |
|---|---|
| **Bank Regulation and Supervision** | |
| Complete the transition towards RBS, complete the implementation of the Risk Management Unit, and define a clear division of labor relative to the existing superintendencies, including responsibility for consolidated supervision. | Near Term/In progress |
| Complete the regulatory framework on market and liquidity risk | Near Term/In progress. |
| Enhance the supervisory capacity building program | Medium Term/Completed |
| Intensify efforts to improve AML/CFT, taking into account the results of the mutual evaluation now underway | Near term/Completed |
| Provide effective legal protections to current and former supervisors at all levels | Near Term /Completed |
| Develop a methodology for identifying systemically important banks and supervise these intensively | Near term/Completed |
| Provide the CNBS with the power to compel economic groups to provide information on cross-border activities | Near term/Completed |
| Require that the chair of the audit committee of a commercial bank be an independent board member | Near term/Completed |
| Build the capacity of CONSUCOOP to supervise cooperatives, paying special attention to large cooperatives | Near term/Completed |
| Introduce a capital requirement for operational risks | Medium term/Pending |
| **Insurance Regulation and Supervision** | |
| Restore resources to the Insurance Superintendency to allow it to complete its RBS program | Near term/In progress |
| Develop an insurance supervisory manual, including the methodology for RBS | Near term/Completed |
| Amend the Insurance Act to allow the CNBS rather than the BCH to license insurance companies and to devolve rule-making powers from the Congress to the CNBS | Medium term/Completed |
| Require firms to complete an Own Risk and Solvency Assessment (ORSA) to allow a forward-looking assessment of risk and capital needs | Near term/In progress |
| Develop a framework for assessing market conduct risks | Near term/In progress |
| **Stress Testing** | |
| Implement a fully-developed stress testing framework encompassing macro scenario building and satellite models to understand financial sector vulnerabilities to severe shocks | Near term/In progress |
| Coordinate BCH and CNBS work to ensure the smooth integration of macroeconomic and financial models | Near term/In progress |

[1]Based on preliminary information. To be updated during the mission.

# Annex V. Implementation of the 2018 Article IV Recommendations

| **Fiscal Policy** | |
|---|---|
| • In the short run, maintain a prudent fiscal policy to contain vulnerabilities, with proposed reduction in the deficit by ½ percentage point of GDP. In the medium term, make robust the past revenue mobilization gains by phasing out tax expenditures and implement structural reforms to keep a firm grip on the wage bill.<br>• Sustained PFM efforts to entrench accountability and enforcement of the FRL, including: taking part in FAD's Fiscal Transparency Evaluation (FTE); incorporating extra-budgetary trust funds into the budget; and incorporating performance-based indicators into the medium-term fiscal framework.<br>• Implementation of the operational and strategic plan for the revenue administration should be accelerated.<br>• Ensure financial sustainability of ENEE through strengthened program of losses reduction, increased operational autonomy to minimize cost of electricity purchases, and new charges for ancillary services. | • The authorities maintained strong fiscal discipline in 2018. Despite a rising deficit at the ENEE, the NFPS deficit was 0.9 percent of GDP lower than the ceiling in the FRL.<br>• No progress was made in phasing out tax expenditures, introducing reforms in the compensation system, and moving trust funds under the budgetary framework. A FTE was completed, and the authorities are committed to implement its recommendations.<br>• The tax authority continued to implement the recommendations from FAD's TA, and they are committed to complete a TADAT assessment in the near future.<br>• Overdue tariff adjustments consistent with marginal cost-recovery were implemented. A reform plan for the electricity sector was agreed with the private sector, including many of the recommended elements. The authorities have developed concrete steps to implement the plan. |
| **Monetary and Foreign Exchange Policy** | |
| • The supportive monetary stance should start to be reversed to rein in emerging inflation pressures and anchor expectations; monetary impact of the new lending program for housing should be contained.<br>• Reform central bank law to establish clear mandate to control inflation, enhance operational autonomy, and governance and accountability mechanisms. Accelerate the development of money and FX market infrastructure, including through accelerated pace of reduction in FX surrender requirements, adoption of a new securities market law to support domestic capital markets development, and adoption of more transparent and forward-looking communication strategy by the central bank. | • The authorities raised the policy rate by 25 basis points in January 2019—the first hike since 2012. The central bank's liquidity management—aided by lower accumulation of international reserves and fiscal consolidation—helped offset the impact of the lending program, with money growth remaining below nominal GDP growth in 2018.<br>• There was an additional 10 percent reduction in the FX surrender requirement to 70 percent. Supported with additional Fund TA, the authorities made additional progress toward adopting a new securities market law, as well as introducing IFRS and enhancing forecasting capacities at the BCH. |

| Financial Sector | |
|---|---|
| • Continue implementing FSSR recommendations; enhance monitoring of household debt and mitigate the risks associated with large concentration of personal loans in public pension funds' portfolios.<br>• Expansion of lending programs by the public development bank BANHPROVI and pension funds should be gradual. | • The CNBS continued to make progress toward implementing risk-based supervision, introducing a framework to assess market conduct risks, enhancing stress testing capacities, and strengthening the regulatory framework in line with Basel III standards—specifically by starting a gradual introduction of the capital conservation buffer and liquidity coverage ratio.<br>• Net lending by pensions funds in 2018 was lower than under the Fund-supported program PCs for 2016 and 2017. BANHPROVI remains profitable and with low NPLs, although NPLs increased a lot at the agricultural development bank (BANADESA). |
| **Structural Reforms** | |
| • Sustain anti-corruption efforts to enhance the rule of law.<br>• Introduce reforms to make product and labor markets more competitive, including by reforming the minimum wage system. | • Several high profile new anti-corruption cases were initiated in the last year while the cooperation agreement of the public prosecutor's office with the OAS special anti-corruption mission is up for renewal in January 2020. The authorities made additional progress toward developing new legislation requiring public regulatory agencies to streamline, document, and publicize the requirements for obtaining permits. No changes were made to the minimum wage system. |

# Annex VI. Alternative Scenario

**The level of access is justified by the external risks faced by the Honduran economy.** While real growth performance has remained resilient in recent years, Honduras is an energy importer. Given global risks associated with large swings in energy prices (Annex III), a potential deterioration in Honduras's terms of trade makes the current account vulnerable to an increase in the price of oil. An illustrative adverse scenario based on more modest terms of trade growth—a ½ percent increase compared to 2 percent in the baseline, associated with higher oil prices compared to the baseline (by 15 percent in 2019 and about half that rate in 2020 and 2021)—would be associated with lower growth, a higher current account deficit, and slightly higher public debt (the authorities would still comply with the FRL, but they would not overperform). The scenario assumes that the confidence effect of having a Fund program in place helps keep private capital flows broadly unaffected by the shock, but the higher external current account deficit would open a financing gap of about 90 percent of quota.

## Honduras: Medium-Term Scenario (Alternative)

| | Act. | | Prel. | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| | (Annual percent change) | | | | | | | | |
| **Output and Inflation** | | | | | | | | | |
| GDP at constant prices | 3.8 | 4.9 | 3.7 | 3.3 | 3.4 | 3.5 | 3.5 | 3.6 | 3.7 |
| Consumer prices (eop) | 3.3 | 4.7 | 4.2 | 5.2 | 4.7 | 4.5 | 4.2 | 4.0 | 4.0 |
| | (In percent of GDP, otherwise indicated) | | | | | | | | |
| **Nonfinancial Public Sector** | | | | | | | | | |
| Net lending (+) / Net borrowing (-) | -0.5 | -0.8 | -0.9 | -0.9 | -1.0 | -1.0 | -1.0 | -1.0 | -1.0 |
| Primary balance | 0.3 | 0.1 | 0.2 | 0.7 | 0.9 | 0.9 | 1.1 | 1.0 | 0.9 |
| Gross debt | 39.8 | 39.8 | 41.9 | 44.3 | 45.0 | 44.5 | 43.6 | 42.6 | 41.4 |
| Public Investment | 3.2 | 4.3 | 4.1 | 3.3 | 4.0 | 4.3 | 4.3 | 4.7 | 5.0 |
| **External sector** | | | | | | | | | |
| Current account balance | -2.7 | -1.8 | -4.2 | -4.5 | -4.4 | -4.6 | -4.6 | -4.4 | -4.4 |
| Oil price (in U.S. dollars) | 42.8 | 52.8 | 68.3 | 61.9 | 59.5 | 60.0 | 56.6 | 57.4 | 58.1 |
| Reserves loss following shock, excluding IMF financing (in millions of U.S. dollars) | … | … | … | 149 | 81 | 81 | 0 | 0 | 0 |
| GIR excluding IMF disbursements (in months of next year's non maquila imports) | 5.0 | 5.2 | 5.2 | 5.0 | 4.9 | 5.0 | 5.0 | 5.1 | 5.1 |

Sources: Central Bank of Honduras, Ministry of Finance, and Fund staff estimates and projections.

# Appendix I. Letter of Intent

June 20, 2019

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde,

**1. Supported by a Fund program during 2014-17, Honduras has made great strides reducing macroeconomic imbalances and strengthening its policy framework.** It implemented a front-loaded fiscal consolidation through significant revenue mobilization and expenditure control, reducing the fiscal deficit by almost 7 percent of GDP in three years. Moreover, the government institutionalized fiscal prudence by enacting a Fiscal Responsibility Law (FRL) in 2016, which has been overperformed during the last three years, despite the challenges posed by the financial situation of the state-owned electricity company (ENEE). The government also took steps towards modernizing its monetary policy framework—aiming at facilitating a transition towards inflation targeting—and adopted measures to make the financial system more resilient.

**2. While government efforts have spurred growth and established the foundation for sound macroeconomic management, challenges remain to reduce vulnerabilities and risks.** Poverty is still high, which calls for higher social and infrastructure spending to improve social conditions for the Hondurans. While the FRL deficit target continued to be overperformed in 2018, the deteriorating financial situation of ENEE has strained public finances and ultimately domestic demand. To buffer potential external shocks associated with volatile terms of trade and global financial conditions, Honduras also needs to continue strengthening its monetary policy framework. Finally, we believe that an overarching challenge to achieve sustainable inclusive growth is associated with the need to improve governance, which calls for wide-ranging institutional reforms.

**3. The main objective of our 2019-21 economic program is to maintain macroeconomic stability, while enacting economic and institutional reforms to foster inclusive growth.** The main elements of the program include: (i) securing the fiscal position by putting ENEE on a sustainable path through deep reforms while maintaining policy space for investment and social spending; (ii) strengthening monetary policy and financial institutions to buffer shocks and maintaining stability; and (iii) reforms to improve the business environment and governance, including by stepping up efforts in the fight against corruption. We believe that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve objectives of our program, but we will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures, and before any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

**4. In support of our program, we are requesting a 24-month Stand-By Arrangement/Standby Credit Facility with access of US$311 million (SDR 224.82 million, 90 percent of quota).** The arrangements, which we intend to treat as precautionary, will signal our commitment to implement sound economic policies, allow us to catalyze external financial assistance, bolster investor confidence, and firm up social consensus for the reform agenda.

**5. Program implementation will be monitored through semi-annual reviews, with the first one scheduled to be completed by December 2019.** The quantitative performance criteria and indicative targets under the program are set out in Table 1 of the attached MEFP. We also propose a list of prior actions and structural benchmarks in Table 2. We will provide Fund staff with all information required to monitor program performance and complete program reviews.

**6. Consistent with the commitment to keep the public informed, we authorize the IMF to publish this Letter of Intent, its attachments and the related staff report, as well as all future program documents.**

Sincerely yours,

| | | |
|---|---|---|
| /s/ | /s/ | /s/ |
| Marlon Tábora Muñoz | Wilfredo Cerrato Rodriguez | Rocío Tábora Morales |
| Chief of Economic Cabinet | President, Central Bank of Honduras | Secretary of the Treasury |

Attachments (2)

# Attachment I. Memorandum of Economic and Financial Policies

## Background and Program Objectives

1. **Over the last years, Honduras has made great strides reducing macroeconomic imbalances and strengthening its policy framework.** At the onset of the Fund-supported economic program in 2014, Honduras was facing numerous macroeconomic challenges; with slowing economic activity, a challenging external environment and political uncertainty. Fiscal policy in previous years had led to a rapid increase in public debt, the current account deficit had increased, and reserve coverage was limited. Against this backdrop, the government took decisive actions on all fronts. It implemented a front-loaded fiscal consolidation through significant revenue mobilization and expenditure control, reducing the fiscal deficit by almost 7 percent of GDP in three years. Moreover, the government institutionalized fiscal prudence by enacting a Fiscal Responsibility Law (FRL) in 2016, which has been overperformed during the last three years. The government also took steps towards modernizing its monetary policy framework—aiming at facilitating a transition towards inflation targeting—and adopted measures to make the financial system more resilient. This program managed to secure macroeconomic stability and to increase confidence, as manifested by the steady improvement in international sovereign ratings.

2. **While government efforts have spurred growth and established the foundation for sound macroeconomic management, challenges remain to reduce vulnerabilities and risks.** Honduras continues to be one of the poorest countries in the region, with more than 60 percent of households living below the poverty line. In this context, while our commitment with fiscal prudence—enshrined in the FRL—is instrumental to ensure debt sustainability, there is a need to increase social and infrastructure spending to improve social conditions for the Hondurans. To buffer potential external shocks associated with volatile terms of trade and global financial conditions, Honduras also needs to continue strengthening its monetary policy framework. Finally, we believe that an overarching challenge to achieve sustainable inclusive growth is associated with the need to improve governance, which calls for wide-ranging institutional reforms.

3. **The main objective of our economic program is to maintain macroeconomic stability, while enacting economic and institutional reforms to foster inclusive growth.** We remain firmly committed to macroeconomic stability and intends to build on previous achievements to strengthen the policy and institutional framework. Adherence to the FRL will be coupled with reforms aiming at creating space to reduce the infrastructure gap and increase social spending. We intend to preserve previous revenue mobilization efforts, to implement the electricity sector framework law, and put the financial situation of the public electricity company (ENEE) on a sustainable path. The program will continue strengthening monetary policy and financial institutions; and building money and foreign exchange markets to transition towards inflation targeting. Finally, we are fully committed to strengthening governance, including by stepping up efforts in its fight against corruption. These governance reforms will tackle areas that pertain to the macroeconomic policy framework, as well as the rule of law, fundamental to improve the business environment and foster inclusive growth.

### Recent Economic Developments and Outlook

4. **Macroeconomic conditions have remained stable over the last year.** GDP growth reached 3¾ percent in 2018. While economic activity decelerated compared to its buoyant performance in 2017, it remained around potential despite weaker terms of trade, supported by private consumption—which was boosted by remittances. Consumer price inflation is stable around the center of the central bank´s 4±1 percent target band. Driven by the cited decline in the terms of trade—lower coffee prices and higher oil prices—the current account deficit widened to 4¼ last year; but remained close to the historical average. Despite this, given the strong foreign direct investment flows, the coverage ratio of international reserves remained stable at around 5.2 months of non-maquila imports of goods and services. The banking system remained stable, liquid and well capitalized—bank capital is above regulatory requirements and NPLs are at record-low levels.

5. **We have pursued prudent macroeconomic policies.** Despite the challenges posed by the financial situation of ENEE, the deficit of the Nonfinancial Public Sector overperformed compared to the FRL ceiling in 2018—it reached 0.9 percent of GDP, against a target of 1.2 percent of GDP—due to a substantial adjustment at the central government level. As for monetary policy, against a background of inflation expectations still hovering around the upper limit of the target band, the central bank hiked the policy interest rate last January. Since then, inflation expectations fell by about 25 basis points in January—to 4¾ percent—and have been stable afterwards. The central bank remains vigilant to inflation developments and to the evolution of credit to the private sector, and its monetary policy actions will continue to be data dependent.

6. **Policies under the program will uphold macroeconomic performance.** Our policies aim at maintaining the hard-won gains achieved during the previous program in terms of revenue mobilization and promptly implementing reforms in the electricity sector. Fiscal measures and reforms will allow us to open space for investment and social spending, while keeping the fiscal stance within the FRL targets. Growth is projected to slow in the short term, but the recovery in investment and positive confidence effects will support GDP growth to gradually converge towards potential. Inflation and inflation expectations are expected to converge toward the midpoint of the target band, and the current account deficit is expected to remain stable at around 4 percent of GDP.

### Fiscal Policy

7. **Continued fiscal prudence will put public debt on a sustainable path.** We have strived to overperform the FRL since its inception in 2016, notably through the electoral cycle in 2017 and despite the significant challenges raised by ENEE's financial situation in 2018. As this has played a critical role in signaling fiscal prudence and paving the way to put public debt on a sustainable path, the government's fiscal policy will continue to be guided by the FRL in coming years. This will be instrumental to maintaining confidence and keeping Honduras's risk premium low, reducing financing costs for the economy. To protect tax revenue, we will abstain from introducing measures with the potential to lower tax collections—either in the short- or the medium-term.

**8. At the same time, efforts to maintain revenue mobilization and reforms in the electricity sector will increase fiscal space for much-needed investment and social spending.** Measures and reforms—aiming at streamlining tax exemptions and strengthening revenue administration—during the first year of the program will preserve the hard-won level of tax revenues achieved through reforms adopted in the last program. At the same time, bold measures in the electricity sector will put ENEE's financial situation on a sustainable path—including by implementing the electricity sector law approved in 2014, strengthening the regulatory body, addressing governance issues both in the electricity sector and in ENEE, reducing electricity losses and energy purchase costs, keeping tariffs in line with costs, and refinancing ENEE's financial obligations to replace high-cost debt. These reforms will create fiscal space to increase investment and social spending. The FRL targets in terms of current spending and measures to control the wage bill will steer the evolution of other spending.

## A. Revenue

**9. The government strategy regarding revenues aims at keeping revenue mobilization efforts that took place over the last years.** Some changes introduced in the new tax code in 2017—including, inter alia, the increase in gross income exempted of the corporate minimum income tax—are likely to result in a permanent reduction in tax revenue. Considering this, protecting the gains of the recent revenue mobilization efforts will require a number of tax policy and administrative measures:

- **Tax base.** At almost 7 percent of GDP, tax expenditures are large. Such level threats the underlying principles of our economic program by curbing much-needed resources to expand social and infrastructure spending. Revenue mobilization efforts can be maintained without recourse to changes in statutory tax rates. In this context, we will broaden the tax base by streamlining exemptions, while protecting the poor (structural benchmark, December 2019).

- **Control of tax exemptions.** In line with the international best practice, we will propose legislative changes to return to the tax administration office (SAR) the control and verification procedures for the management of tax exemptions (structural benchmark, December 2019).

- **Strengthening tax administration.** Several amnesties have been implemented in recent years, which yielded some short-term resources at the price of weakening medium-term tax enforcement. Considering this, we will not issue new tax amnesties, widen the scope for rescheduling of tax liabilities, or grant tax relief in any form.

- **Customs.** We will terminate the operations of COPRISAO by enacting the decree that creates the new customs administration (structural benchmark, September 2019). We will also appoint its new managerial team.

- **Modernization of tax procedures.** We will introduce electronic notification of SAR procedures to taxpayers (structural benchmark, December 2019) and develop a plan to upgrade our obsolete system based on exempted purchase orders—which is cumbersome, bureaucratic, and costly—with a modern system based on timely tax refunds.

- **Information sharing.** SAR, the ministry of finance, and the customs administration will sign an agreement to share information on a timely basis.

## B. Spending

**10. Rightsizing expenditure will continue to guide our policy of fiscal prudence.** We have been implementing measures to contain current spending growth, as mandated by the FRL. This containment is needed to expand social and infrastructure spending. Specifically, our spending plan includes the following:

- **Wage bill.** In the short term, we will create and implement a centralized wage bargaining mechanism to guide decisions on nominal wage increases, in line with the FRL (structural benchmark, December 2019). Over the medium-term, we plan to upgrade the general directorate of civil service to a public administration authority in charge of reforms to right-size the number of labor frameworks existing in the public sector and establish a modern civil service career aligned with merit and performance.

- **Goods and services.** We will control spending in goods and services by streamlining unnecessary travels, consultant services, and temporary contracts.

- **Public investment.** We will continue prioritizing projects that are key to enhancing Honduras's competitiveness.

## C. Financing

**11. Our program is fully financed.** From multilateral development banks, we envisage total disbursements of about US$1.2 billion during 2019-21. For the same period, we expect disbursements for about US$0.5 billion from bilateral loans and US$0.6 billion from market operations. We anticipate that, in the context of strong program implementation, financing conditions for Honduras will improve. Thus, we will consider further operations in global markets to take advantage of opportunities for reprofiling operations, aiming at replacing high-interest, short-maturity domestic debt with cheaper and longer-maturity external debt. With the program fully financed, we are confident that we will not need to withdraw resources from the IMF.

**12. Domestic arrears.** ENEE has been accumulating domestic arrears to private generators. As of March 2019, these arrears were estimated at about 1½ percent of GDP. We are planning to conduct a full review of these arrears and then gradually clear them.

## D. Fiscal Governance and Transparency

**13. The quality of fiscal policy relies on sound governance and transparency of public spending.** We are committed to enhancing the quality of public expenditure, so that policies supported by our sustained revenue mobilization efforts succeed in delivering the public services demanded by the population. Transparency and strong governance are key factors to achieve these aims. In line with this, we are implementing the recommendations of the Fiscal Transparency Evaluation (FTE) recently conducted by the Fund. We are also committed to developing a plan to enhance fiscal governance, supported by technical assistance from the Fund.

**14. The incorporation of expenditure channeled through trust funds into the budget is important to secure efficiency and accountability.** To align our expenditure policies with the budget unity principle, we will take steps to transfer well-established programs to the budget. As a first step, we will include an annex on spending by trust funds in the 2020 budget proposal to be submitted to Congress (structural benchmark, September 2019). We will present a plan to execute spending currently funneled through social and infrastructure trust funds under full Public Financial Management regulations starting with the 2021 budget (structural benchmark, March 2020). We will introduce a mandatory assessment from the ministry of finance as a pre-condition for contracting debt by trust funds starting in the 2020 budget.

**15. We will take additional measures included in FTE recommendations.** We are committed at enhancing the comprehensiveness of fiscal reports and strengthen the assessment of fiscal risks—particularly those stemming from trust funds and financial and non-financial public companies—through the publication of an annual Fiscal Risk Statements. This will include proposed contingent policies for risks with high probability of materialization. Moreover, we will work to strengthen the Unit of Norms and Processes in the budget office, aiming at creating an expenditure quality unit. The unit will be tasked with identifying the main sectors where performance budgeting pilots can be applied, as well as with developing the relevant indicators and their corresponding baselines—focus will be placed on improving the quality of expenditure in the sectors that are critical for the social wellbeing and long-term development.

### Electricity Sector: Governance and Sustainability

**16. Our plans for the electricity sector comprise both institutional reforms and a profound corporate restructuring of the public electricity company (ENEE).** An action plan will be shared with Fund' staff at least five days before the Board meeting (prior action).

**17. The structural overhaul of the electricity market constitutes a cornerstone in our economic program.** We will implement the approved electricity framework law, which aims at rehabilitating and upgrading the sector's infrastructure and mobilizing investment resources. The centerpiece of the reform is the creation of the system operator in charge of managing the power grid to ensure the reliable delivery of electricity to residential, commercial, and industrial consumers. This aims at promoting a more efficient, open, and transparent sector that fosters private investment.

**18. The new structure of the electricity sector requires both a new tariff scheme and a strong regulatory framework.** We will adopt a new tariff scheme—prepared with assistance from the World Bank—that reflects generation, distribution, transmission, and other costs to provide electricity services (prior action). We will also ensure the budgetary and operational autonomy of the electricity regulatory body (CREE). As stated in the law, the CREE will enact quarterly adjustments in the tariffs to ensure that prices are aligned with operational costs (continuous structural benchmark).

**19. We are committed to tackle long-standing challenges in ENEE.** The company's financial situation is critical—its deficit reached 1 percent of GDP in 2018, owing to lack of strategic planning that gave place to oversupply and high generation costs, a misalignment between tariffs and costs, high electricity losses, governance issues, and persistent operational inefficiencies. Over time, these weaknesses have resulted in a large accumulation of debt—close to 11 percent of GDP—and the loss of the company's financial autonomy. Our reform plan is structured around the following elements:

- *The unbundling of the company.* As mandated by the electricity framework law, with technical support from the Inter-American Development Bank, ENEE will be unbundled into three independent companies that will operate in three different markets—generation, transmission, and distribution. The separation of the company provides the potential to create investment opportunities for strategic partners that will gradually facilitate the needed investment in the electricity sector.

- *Addressing financial and generation issues.* We plan to reach market-friendly restructuring agreements with ENEE's creditors to reduce financing costs. Additionally, in strict adherence to our legal framework, we will seek a more efficient generation—including the revision of approved contracts not yet in operation—and prevent the materialization of contingencies.

- *Reducing electricity losses.* The current level of losses is testimonial of operational inefficiency. We have decided to revamp our strategy to reduce electricity losses in transmission and distribution. As part of this, we will (i) revise, following due process, the contract with *Empresa Energía Honduras* (EEH)—the operator of the distribution system—to strengthen an effective losses reduction plan; (ii) conduct more targeted field assessments looking for irregular connections, tampered or damaged meters, and unmetered consumers; and (iii) continue upgrading the metering infrastructure. We also plan to deploy a law enforcement task force to strengthen this strategy.

**20. Our comprehensive energy sector reform plan includes appropriate support for the poor.** It will clearly state its long-term objectives, in consultation with key stakeholders. The analysis of the impact of the reform will be clearly communicated to the public, and measures will be appropriately phased. Moreover, specific programs to protect the poor have been put in place already, including by maintaining the electricity subsidy for those consuming less than 75kwh per month and by introducing transitory budgetary transfers for low-consumption households after the tariff adjustment in April.

## Monetary Policy

**21. The central bank (BCH) will continue to control inflation and maintain an adequate level of international reserves.** The BCH will seek to keep headline inflation within the 4±1 percent target band. The program will include ceilings on the expansion of net domestic assets and floors on the accumulation of non-borrowed net international reserves of the central bank as performance criteria. To ensure that the growth in private sector credit is in line with the program objectives, the BCH will keep credit developments under close review and will use its monetary policy instruments as needed. We will not provide additional financing to BANHPROVI beyond that envisaged under the trust fund approved in 2013.

**22. We will continue to improve the operational framework for conducting monetary policy, aiming at the implementation of full-fledged inflation targeting in coming years.** A critical element to meet this end is the new central bank charter, which we aim to submit to Congress in December 2019 (structural benchmark), supported by continued technical assistance from the Fund to strengthen the central bank's capacity building required to implement these reforms. The charter will safeguard operational autonomy and will increase transparency and accountability of the institution by, *inter alia*, stating price stability as the policy mandate of the BCH, improving transparency by introducing the International Financial Reporting Standards, securing a sound central bank's governance structure, and clarify operational, oversight, and policy decision responsibilities.

**23. Continuous cooperation between the central bank and the ministry of finance will be of the essence to enhance the operational framework for monetary policy.** In the past, coordination has resulted in a successful recapitalization of the central bank. Going forward, we believe that coordination has the potential to further increase efficiency in money markets by reducing market fragmentation between central bank and treasury instruments. In line with this, we will assess the benefits of signing an agreement between the central bank and the ministry of finance to give the former unrestricted access to a pool of government securities to implement monetary policy—as it is successfully done in other countries—with the proceeds of these placements to be deposited in a [sterilized] account at the central bank.

**24. Our exchange rate policy will include gradual steps towards a flexible exchange rate regime.** Over the medium term, this will allow the Honduran economy to adjust to terms-of-trade and other external shocks. As of May 2019, we have liberalized 30 percent of the foreign exchange market. We will present a plan for the gradual removal of the remainder 70 percent foreign exchange surrender requirements (structural benchmark, December 2019).

**25. As part of our transition to inflation-targeting, we are working to improve pricing and economic activity statistics that are critical to assess the monetary stance.** We will complete by September 2020 the National Household Income and Expenditure Survey (NHIES), with the aim of publishing a new consumer price index (CPI) by December 2021. We are also working on a project to rebase the national accounts series to 2016. We are committed to publishing the new national accounts series by December 2021.

## Financial Policies

**26. We are fully committed to further improving the regulatory framework and supervisory practices in the financial system.** In line with the FSSR recommendations and the Basel III standard, we plan to: (i) further strengthen the capacity for risk-based supervision; (ii) keep developing stress testing capacities; (iii) phasing in the liquidity coverage ratio and capital conservation buffer requirements as currently scheduled; (iv) establish a timeframe for the introduction of an additional capital charge for systemic banks; (v) introduce regulations for market risks; and (vi) develop new methodologies to assess operational risks. The CNBS will also complete implementation of the bank resolution framework by creating guidelines for banks to prepare their recovery plans and develop manuals for bank resolution mechanisms. We will remain vigilant to the evolution of credit growth as well—especially in foreign currency, with a view of considering tightening the macro-prudential framework.

**27. Improving access to credit of small- and medium-size agricultural producers is a key element in our economic program.** Given the situation of financial insolvency of the public agricultural development bank (BANADESA), we will continue the process envisaged in the financial sector law and send Congress a proposal to address its financial situation (structural benchmark, December 2019).

**28. We will continue to assess improvements to the investment policy framework of public pension funds.** Pension funds' investment policy frameworks should aim at aligning the maturity of their assets and liabilities. Therefore, we will gradually move the structure of their investment portfolio towards international best practices. We will also assess whether lending policies place the incentives to secure the right amount of accumulated rights—net of outstanding loans—at the time of retirement.

**29. We will work with Congress to approve a new securities market law to support the development of domestic capital markets.** Modernizing our legal framework is critical to broaden financing options for the private sector and investment alternatives for institutional investors. The development of domestic capital markets will also strengthen the interest rate channel of monetary transmission, supporting the transition to inflation targeting.

## Social Policies

**30. Reducing the unacceptable high poverty rate is critical for the success of our reform agenda.** Therefore, it is critical to put measures in place to combat poverty and favor social mobility—by focusing on women and early-age children.

**31. Priority social spending.** We will define a set of social programs to be monitored during periodic reviews (indicative target), which is testimonial to our commitment to further expand the social safety net. The priority social spending will be channeled mainly through well-targeted cash transfers or other similar programs, including support for returning migrants. We will expand our flagship cash-transfer program "*Bono Vida Mejor*", aiming at covering population in extreme poverty by end-2021.

**32. Electricity subsidy.** As suggested above, we will continue providing the subsidy for households consuming up to 75KW per month and provide additional temporary subsidies to buffer the impact of higher energy price on households.

**33. Gender equality.** Raising female labor participation is critical to boost potential growth. We will tailor our subsidized lending programs to small and self-employed producers to ensure adequate gender distribution that contributes to a gradual closing of the gender gap in the labor market. Some of our key programs in this area—*Primera Infancia, Ciudad Mujer, and Empoderamiento Económico de la Mujer*—will be included as priority social spending.

### Governance, Rule of Law and Business Environment

**34. Business climate.** Fostering the conditions for private sector activity is critical to our economic program. Steps have been taken for further administrative simplification; and a one-step window is being implemented for international trade. We will submit to Congress legislation requiring public regulatory agencies to streamline and publicize requirements for obtaining permits, to reduce discretion and accelerate approvals (structural benchmark, March 2020). We will also develop a plan to implement the electronic signature to simplify public administration procedures (structural benchmarks, December 2019).

**35. Governance.** We are working with Fund staff to conduct a governance diagnostic aiming at improving the legal framework and its institutional set-up and implementation. We are committed to incorporating the recommendations of the diagnostic according to a plan to be discussed during the first review, potentially covering fiscal, bank and market regulations, rule of law, AML/CFT, and transparency and corruption areas.

**36. AML/CFT.** We are committed to continuing strengthening our AML/CFT framework, in line with recommendations of the Financial Action Task Force of Latin America (GAFILAT)**.** We will continue to expand supervision coverage of Designated Non-Financial Businesses and Professions (DNFBPs); and assess the appropriateness of the identification of shareholders and beneficial owners of incorporated companies for AML/CFT purposes. Separately, the CNBS will continue to strengthen cooperation with the superintendency of cooperatives on capacity development areas.

### Safeguards Assessment and Program Monitoring

**37. Fund staff will be updating the safeguards assessments of the BCH.** The update will be completed before the first program review. We will implement the recommendations that arise from the assessment.

**38. Program monitoring.** The program will be subject to semi-annual reviews, and will be monitored through performance criteria, indicative targets, and structural benchmarks, as set out in tables 1 and 2. The first review is expected to be conducted in December 2019 and the second review in April 2020. To facilitate program monitoring, we are committed to provide detailed information as specified in the technical memorandum of understanding (TMU). Relevant definitions and reporting procedures are further specified in the accompanying TMU.

**39. Program Monitoring Committee (PMC).** The PMC—comprising the chief of the economic cabinet, the president of the central bank, the minister of finance, the director of SAR, the president of the CNBS, the chief economist of the central bank, and the director of macro-fiscal policy at the ministry of finance—will meet at least once a month to review implementation of the Fund-supported program and consistency of all relevant policy initiatives with the program's objectives. The Fund resident representative will attend the meetings as an observer. The central bank will prepare minutes of the meetings and send them to the Fund resident representative no later than five business days after each meeting.

### Table AI.1. Honduras: Prior Actions and Structural Benchmarks 2019-20

| Measure | Target Date |
|---|---|
| **Prior actions** | |
| Approve new tariff scheme that secures the recovery of electricity generation and ENEE's operational costs. | Five business days before the Board meeting |
| Prepare a plan to secure financial sustainability in ENEE, including a debt profile and policies for energy purchase that are consistent with the new electricity tariff scheme. | Five business days before the Board meeting |
| Present a plan to secure a reduction in electricity losses, starting in 2019, with a floor of 3 percent per year from 2020 onwards. | Five business days before the Board meeting |
| **Structural benchmarks** | |
| Ensure that CREE implement periodic tariff adjustments aligned with the evolution of energy generation costs. | Continuous |
| Include an annex on spending by trust funds in the 2020 budget proposal to be submitted to congress. | September 2019 |
| Enact the decree that creates the new customs administration and appoint its managerial team. | September 2019 |
| Introduce legislation to transfer all verification procedures for the management of tax exemptions from SEFIN to SAR. | December 2019 |
| Amend Article 89 of the Tax Code, allowing for electronic notification of SAR procedures to taxpayers. | December 2019 |
| Streamline tax exemptions, including those that are not in line with commitments under the benefit and/or lack proof of economic impact. | December 2019 |
| Submit to Congress the new draft BCH charter, in line with the recommendations of Fund staff (see paragraph 22 of the MEFP). | December 2019 |
| Present a plan to phase out FX surrender requirements. | December 2019 |
| Establish a centralized wage bargaining mechanism, in line with the FRL. | December 2019 |
| Submit to Congress of a proposal to address the financial situation in BANADESA. | December 2019 |
| Prepare a plan to implement electronic signature. | December 2019 |
| Submit to congress draft legislation requiring regulatory agencies to streamline and publicize requirements for obtaining permits. | March 2020 |
| Present a plan to execute social and infrastructure spending currently funneled by trust funds to be managed within full PFM regulations for the 2021 budget. | March 2020 |

## Table AI.2. Honduras: Performance Criteria 1/

(Cumulative flows; millions of Lempiras, unless specified)

| | 2019 | | 2020 | |
|---|---|---|---|---|
| | End-Sep. | End-Dec. | End-Jun. | End-Dec. |
| | Prog. | Prog. | Prog. | Prog. |
| **QUANTITATIVE PERFORMANCE CRITERIA** | | | | |
| **Fiscal targets 2/** | | | | |
| Net lending/borrowing of the nonfinancial public sector (-= borrowing, floor) | -3,898 | -5,569 | -3,105 | -5,175 |
| Net lending/borrowing of ENEE (-= borrowing, floor) /3 | -4,312 | -6,160 | -3,264 | -5,440 |
| Lending minus repayments from public pension funds (ceiling) | 600 | 800 | 525 | 700 |
| **Public debt targets** | | | | |
| Accumulation of domestic arrears by ENEE (ceiling) 4/ | 0 | 0 | 0 | 0 |
| Accumulation of new external arrears (ceiling, in million US$) 5/ | 0 | 0 | 0 | 0 |
| **Monetary targets** | | | | |
| Change in the stock of non-borrowed net international reserves of the Central Bank (floor, in million US$) | 3,738 | 3,858 | 3,898 | 4,026 |
| Stock of net domestic assets of the central bank (ceiling) 6/ | -50,679 | -52,300 | -51,574 | -53,266 |
| **QUANTITATIVE INDICATIVE TARGETS 2/** | | | | |
| Tax revenue of the central government (floor) | 66,502 | 110,837 | 72,725 | 121,208 |
| Wage bill of the central government (ceiling) 7/ | 28,200 | 47,000 | 30,300 | 50,500 |
| Priority Social spending (floor) | 1,762 | 5,873 | 2,193 | 7,309 |
| Operating revenue-to-spending ratio of ENEE (floor) | 0.99 | 1.02 | 1.02 | 1.04 |

1/ Definitions as specified in the Technical Memorandum of Understanding.
2/ Cumulative starting in January of the correspondent year.
3/ Excluding subsidies from the central government.
4/ As defined in the Technical Memorandum of Understanding.
5/ Continuous PC.
6/ Using the program exchange rate of L24.4316 = 1US$.
7/ Corresponds budgetary central governement (*Administración Central*) in the authorities' sectorization.

# Appendix to the MEFP: Main Policies and Structural Reform Program

## A. Public Finances

### Tax Policy

**1.** Do not issue additional tax amnesties, regularizations and exemptions, including by abstaining from extending existing regularizations.

**2.** Publish a list of tax exemptions and eliminate those that: (i) are not in line with the commitments of the approved benefit; and (ii) have no proof of economic impact (Article 20.3 of the Tax Code).

### Tax and Customs Administration

**3.** Transfer all operational management of tax exemptions from SEFIN to SAR, including by replacing the system of "purchase orders" with tax refunds for VAT exempted taxpayers.

**4.** Amend Article 89 of the Tax Code—which requires personal notification to taxpayers—allowing for electronic notification of tax noncompliance by the SAR (structural benchmark).

**5.** Sign and implement the agreement for the exchange of information between DARA, SAR, and SEFIN.

**6.** Enact the decree that creates the new customs administration and appoint its executive authority (structural benchmark).

### Expenditure Policy

**7.** Upgrade the General Directory of Civil service to a public administration authority in charge of establishing a pay policy for the whole public sector and reducing the fragmentation of labor regimes.

**8.** Substitute (all kinds of) wage indexation with a non-automatic and centralized bargaining mechanism for the public-sector, consistent with fiscal affordability within the medium-term fiscal framework.

### Public Financial Management: Governance and Expenditure Quality

**9.** Include an annex on spending by trust funds in the 2020 budget proposal submitted to Congress (structural benchmark).

**10.** Present a plan to allow trust funds to be managed within the full PFM legal framework—as per Article 26 of the Fiscal Responsibility Law—in the 2021 budget proposal (structural benchmark).

**11.** Publish an annual Fiscal Risk Statement to quantify and mitigate fiscal risks related to trust funds and financial and non-financial SOEs.

**12.** Make the Unit of Norms and Processes in the budget office operational as an expenditure quality unit in charge of developing a plan to extend performance budget pilots to areas in the health and education sectors.

**Electricity Sector: Governance and Structural Issues**

**13.** Approve a new tariff scheme that secures the recovery of electricity generation and ENEE's operational costs (prior action).

**14.** Secure budgetary and operational independence in CREE, and the automatic implementation of periodic tariff adjustments that reflect the evolution of energy generation costs (continuous PC).

**15.** Prepare a plan to secure financial sustainability in ENEE, including a debt profile and policies for energy purchase that are consistent with the new electricity tariff scheme (prior action).

**16.** Present a plan to secure a reduction in electricity losses, starting in 2019, with a floor of 3 percent per year from 2020 onwards (prior action).

**17.** Conduct an audit of ENEE financial accounts for the 2019 fiscal year.

## B. Financial Sector

**18.** National Banking Commission (CNBS) to issue prudential regulations for the investment of pension funds in line with international best practices, including limits on the share of consumer loans in their portfolios.

**19.** Amend the budget framework law to allow liability management operations by SEFIN, including debt buybacks.

## C. Monetary Sector

**Monetary Policy and Governance**

**20.** Abstain from central bank financing to BANHPROVI beyond the level envisaged in the trust fund approved in 2013.

**21.** Present a plan to address the financial situation in BANADESA (structural benchmark).

**22.** Submission to Congress of the new central bank law charter stating the supremacy of inflation target and strengthening institutional, operational, and financial independence in line with Fund technical assistance (structural benchmark).

**23.** Sign an agreement between the BCH and SEFIN to guarantee the former access to a pool of government securities to conduct monetary policy; and gradually increase the use of these securities to: (i) reduce excess liquidity in the banking system (replacing current BCH paper); and (ii) replace the one-day BCH bills auction with auctions of repo and reverse repos.

**24.** BCH to adopt the IFRS as the accounting framework to prepare and disseminate its financial statements.

**Exchange Rate Policy**

**25.** Establish a calendar to lift surrender requirements to the BCH, simultaneously allowing for increasing interbank foreign exchange transactions (structural benchmark).

**26.** Present a plan to gradually develop an intervention budget, and a set of intervention rules that should be approved and published by the BCH.

## D. Governance: Rule of Law and Corruption

**27.** In line with Fund recommendations, develop and action plan and implement measures to address governance issues associated with rule of law, AML/FT and corruption.

## E. Governance: Market Regulations

**28.** Implement electronic signature as part of the project to upgrade the National Registry of Persons.

**29.** Approve new policy of 'simplificación administrativa' to reduce red tape and enhance governance.

## F. Social Policies

**30.** Assess the efficiency of social spending, and present a sustainable plan to increase its coverage, including to families in extreme poverty.

# Attachment II. Technical Memorandum of Understanding

**1. This memorandum sets out technical understandings between the Honduran authorities and the Fund staff for monitoring of the economic program agreed for the period July 2019–June 2021.** It defines the concepts used to assess observance of quantitative performance criteria, structural benchmarks, and indicative targets specified in Tables AII.1 and AII.2 of the Memorandum of Economic and Financial Policies (MEFP). It also specifies the frequency of the data to be provided to the Fund to monitor the developments under the program.

**2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined below, except for items related to fiscal operations which will be measured at current exchange rates.** The program rates are those that prevailed on March 29, 2019. Accordingly, the exchange rates for the purposes of the program are show in Table AII.1.

**Table AII.1. Program Exchange Rates**

| | |
|---|---|
| Lempira to the U.S. dollar | 24.43 |
| U.S. dollar to the SDR | 0.72 |
| U.S. dollar to the Yen | 110.92 |
| U.S. dollar to the Euro | 0.89 |
| U.S. dollar to the Canadian dollar | 1.34 |
| U.S. dollar to the Bristish Pound | 0.76 |
| U.S. dollar to the the Renminbi | 6.72 |

**3. Any variable that is mentioned herein for the purposes of monitoring a PC or IT and that is not explicitly defined, is defined in accordance with the Fund latest statistical manuals.**

## A. Quantitative Performance Criteria: Definition of Variables

**4. Definitions:**

- The central government for the purposes of the program consists of the budgetary central government (*Administración Central*), fiduciary funds, decentralized institutions (*desconcetradas*), and the Social Investment Fund (FHIS).
- The nonfinancial public sector (NFPS) for the purposes of the program consists of the central administration as defined above, the social security institute (IHSS), all state-owned public pension funds, local governments, other decentralized agencies, and nonfinancial public enterprises.

### Cumulative Floor of NFPS' Net Lending

5. **Definitions:** Net lending of the NFPS is defined as the difference between revenue and expenditure. NFPS' revenue is recorded on a cash basis and include taxes, social contributions, grants, and other revenue—except for revenue of nonfinancial public enterprises, which will be recorded on an accrual basis. Payments from private users of public-private partnerships (PPPs) facilities will be considered public revenue.

6. **NFPS expenditure is recorded on accrual basis and includes expense and net acquisition of nonfinancial assets.** Private investment for PPPs is treated as expenditures and measured as part of the NFPS government net lending as they occur.

7. **NFPS' net lending will be measured at each test date as the cumulative value starting from the beginning of each calendar year.**

8. **Monitoring.** All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

### Cumulative Floor of ENEE's Net Lending

9. **Definitions:** Net lending of ENEE is defined as the difference between revenue and expenditure. Revenues and spending will be recorded on an accrual basis. For program purposes, it will be defined excluding subsidies from the central government to the company.

10. **ENEE's net lending will be measured at each test date as the cumulative value starting from the beginning of each calendar year.**

11. **Monitoring.** All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

### Cumulative Floor of Lending minus Repayments from Public Pension Funds

12. **Definitions:** Lending minus Repayments from Public Pension Funds is defined as loans to their affiliates made by public pension funds net of repayments received by them. Public pension funds included for this calculation are INJUPEMP, INPREMA, IMPREUNAH, and IPM.

13. **Lending minus Repayments from Public Pension Funds will be measured at each test date as the cumulative value starting from the beginning of each calendar year.**

14. **Monitoring.** All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

### Ceiling on the ENEE's Accumulation of Domestic Arrears

**15. Definition:** Arrears of ENEE are defined as overdue payments of ENEE. Technical delays stemming from the payment process will not be considered arrears. Technical delays are defined as unpaid claims still under the maximum period allowed for payment stated in the law on state contracts (Decree 74-2001). This decree states a deadline up to 45 days starting from the submission of appropriate documents for payment. This definition does not preclude payment before the deadline if it is agreed by both parties.

**16. ENEE's Accumulation of Domestic Arrears is measured as the increase in the stock of arrears at each test date relative to the stock of arrears recorded at June 28, 2019.**

**17. Monitoring.** All fiscal data referred to above and needed for program monitoring purposes will be provided to the Fund with a lag of no more than 45 calendar days after the end of each month.

### Ceiling on the Non-Accumulation of External Debt Payment Arrears

**18. Definition of debt:** External debt is determined according to the residency criterion. The term "debt"[1] will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of financial and nonfinancial assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take several forms; the primary ones being defined as follows:

- Loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

- Suppliers' credits, i.e., contracts where the supplier allows the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided, and

- Leases, i.e., arrangements under which the lessee has the right to use the provided property for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the program, the debt is the present value (at the inception of the lease) of all lease payments expected to

[1] As defined in Guidelines on Public Debt Conditionality in Fund Arrangements, Decision No 15688-(14/107).

be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

**19. Definition of external arrears:** External debt payments arrears for program monitoring purposes are defined as external debt obligations (principal and interest) falling due after June 30, 2019 that have not been paid, considering the grace periods specified in contractual agreements. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

**20. Coverage:** This performance criterion covers the NFPS. This performance criterion does not cover (i) arrears on trade credits, (ii) arrears on debt subject to renegotiation and restructuring; and (iii) arrears resulting from the nonpayment of commercial claims that are the subject of litigation initiated prior to June 28$^{th}$, 2019.

**21. Monitoring:** This PC will be monitored on a continuous basis.

**Floor on the Change in Non-Borrowed Net International Reserves**

**22. Definitions:** Non-Borrowed Net International Reserves (NIR) of the BCH are equal to the balance of payments concept of NIR defined as the U.S. dollar value of gross international reserves of the BCH minus gross official liabilities as defined below. Non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollar at the program exchange rates.

**23. Gross official reserves** are defined consistently with the Sixth Edition of the Balance of Payments manual and International Investment position Manual (BMP6) as readily available claims on nonresidents denominated in foreign convertible currencies. They include the (i) monetary claims, (ii) free gold, (iii) holdings of SDRs, (iv) the reserve position in the IMF, and (v) holdings of fixed income instruments. Excluded from reserve assets are any assets that are pledged, collateralized or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currency *vis-à-vis* domestic currency (such as futures, forwards, swaps and options), precious metals other than gold, assets in nonconvertible currencies and illiquid assets.

**Table AII.2. External Program Disbursements**

| Cumulative flows | Million of US$ |
|---|---|
| **Budget Support Loans** | |
| end-September 2019 | 0 |
| end-December 2019 | 155 |
| end-June 2020 | 0 |
| end-December 2020 | 192 |

**24. Gross official liabilities** in foreign currencies include (i) all borrowed reserves, including foreign currency swaps, loans, and repo operations with all counterparties (domestic and foreign), regardless of maturity, (ii) other foreign currency liabilities including deposits of financial institutions, (ii) the use of Fund resources for Balance of Payments support extended in the context of the exceptional financing package, (iii) any deliverable forward foreign exchange

(FX) liabilities on a net basis—defined as the long position minus the short position payable in foreign currencies. The change in non-borrowed net international reserves will be measured as the change in the stock of non-borrowed NIR at each test date relative to the stock at end-December of the previous year.

**25. Monitoring:** Foreign exchange asset and liability data will be provided to the Fund at monthly frequency, within 2 weeks of the end of each month.

**26. Adjustors**

- **Adjustor for multilateral loans.** The NIR target will be adjusted upward (downward) by the surplus (shortfall) in program loan disbursements from the IMF and other multilateral institutions, relative to the baseline projection reported in Table AII.2. Program loan disbursements are defined as external loan disbursements (excluding project financing disbursements) from official creditors that are usable for the financing of the NFPS.

**Ceiling on the Stock of the BCH's Net Domestic Assets**

**27. Definitions.** Net Domestic Assets (NDA) of the BCH are defined as the difference between currency issued and non-borrowed NIR measured at program exchange rates.

**28. The ceiling applies to the stock of NDA measured at each test date.**

**29. Monitoring:** Data will be provided to the Fund monthly with a lag of no more than 2 weeks.

**30. Adjustor for multilateral loans.** The NDA target will be adjusted downward (upward) by the surplus (shortfall) in program loan disbursements from the IMF and other multilateral institutions and grants, relative to the baseline projection reported in Table AII.2. Program loan disbursements are defined as external loan disbursements (excluding project financing disbursements) from official creditors that are usable for the financing of the NFPS.

## B. Quantitative Indicative Targets: Definition of Variables

**Floor in the Central Government's Tax Revenues**

**31. Definition:** Tax revenue will be measured on a cash basis at the level of the central government. All compulsory and unrequited receivables by the government will be considered taxes as stated in the GFSM 2014.

**32. For compliance with this IT the central government will be equivalent to the budgetary central government (*Administración Central*).**

**33. Monitoring.** Monthly data will be provided to the Fund no more than 2 weeks after the end of the month.

### Ceiling on the Central Government's Wage Bill

**34. Definition:** The wage bill is defined as all wages and salaries measured on an accrual basis, including all cash and in-kind wage and salaries and severance payments, plus employers' social benefits.

**35. For compliance with this IT the central government will be equivalent to the budgetary central government (*Administración Central*).**

**36. Monitoring.** Quarterly data will be provided to the Fund no more than within 45 days of the end of each month.

### Floor on Priority Social Spending

**37. Priority social spending** is defined as the public interventions with high impact on poverty reduction and long-term influence on beneficiaries. Interventions oriented to increase the participation of women in the labor market are also included. For program purposes, all interventions listed in Table AII.3 will be considered priority social spending.

**Table AII.3. Priority Social Spending**

| |
|---|
| Social Safety Net |
| Better families |
| School lunch |
| Teen pregnancy prevention program |
| Criando con amor |
| Conditional Cash Transfer |
| Other "Vida Mejor" interventions |
| Early childhood |
| Childcare |
| Support for people with disabilities |
| Ciudad Mujer |
| Strenghtening pre-elementary education |
| Maternal and Newborn Health Integration |
| Assistance to endangered woman/children |
| Opportunities for young mothers |
| Assistance to people with special abilities |
| Woman empowerment through credit |
| Electricity Subsidy for low-income consumers |

**38. Monitoring.** Quarterly data will be provided to the Fund no more than within 45 days of the end of each month.

### Floor on ENEE's Operating Revenue-to-Spending Ratio

**39. Definition:** Operating revenue-to-spending ratio of ENEE is defined as the ratio of operating revenue to operating expenditure. Operating revenue will be defined as current revenue excluding interest earnings and subsidies from the central government. Operating expenditure will be defined as total expenditure excluding interest payments and capital spending.

**40. Monitoring.** Quarterly data will be provided to the Fund no more than within 45 days of the end of each month.

INTERNATIONAL MONETARY FUND

# HONDURAS

June 21, 2019

## STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR AN STAND-BY ARRANGEMENT AND AN ARRANGEMENT UNDER THE STANDBY CREDIT FACILITY—INFORMATIONAL ANNEX


Prepared by: The Western Hemisphere Department
(In Consultation with other Departments)


## CONTENTS

# FUND RELATIONS

(As of April 30, 2019)

## Financial Relations

**Membership Status:** Joined: December 27, 1945

| **General Resources Account:** | **SDR Million** | **% Quota** |
|---|---|---|
| Quota | 249.8 | 100.00 |
| Fund holdings of currency (Exchange Rate) | 211.1 | 84.51 |
| Reserve Tranche Position | 38.7 | 15.49 |

| **SDR Department:** | **SDR Million** | **% Allocation** |
|---|---|---|
| Net cumulative allocation | 123.85 | 100.00 |
| Holdings | 53.46 | 43.16 |

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:**

| Type | Date of Arrangement | Expiration Date | Amount Approved (SDR Million) | Amount Drawn (SDR Million) |
|---|---|---|---|---|
| Stand-By | 12/03/2014 | 12/02/2017 | 77.70 | 0.00 |
| SCF | 12/03/2014 | 12/02/2016 | 51.80 | 0.00 |
| Stand-By | 10/01/2010 | 3/31/2012 | 64.75 | 0.00 |

**Projected Payments to Fund**
**(SDR Million; based on existing use of resources and present holdings of SDRs):**

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2022 | 2023 |
| Principal | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Charges/Interest | 0.60 | 0.81 | 0.81 | 0.81 | 0.81 |
| **Total** | **0.60** | **0.81** | **0.81** | **0.81** | **0.81** |

**Implementation of Enhanced HIPC Initiative: Enhanced Framework**

| | |
|---|---|
| **Commitment of HIPC Assistance** | |
| Decision point date | June 2000[1] |
| Assistance committed (NPV terms) | |
| Total assistance (US$ million) | 556.00 |
| *Of which*: IMF assistance (US$ million) | 30.30 |
| Completion point date | April 2005 |

**Disbursement of IMF Assistance (SDR million)**

| | |
|---|---|
| Amount disbursed | 22.66 |
| Interim assistance | 8.80 |
| Completion point balance | 13.86 |
| Additional disbursement of interest income | 3.70 |
| **Total Disbursements** | **26.36** |

**Implementation of MDRI Assistance**

| | |
|---|---|
| Total Debt Relieve (SDR million)[2] | 107.46 |
| *Of which*: MDRI | 98.24 |
| HIPC | 9.21 |
| Debt Relief by Facility (SDR million) | |

| | **Eligible Debt** | | |
|---|---|---|---|
| **Delivery Date** | **GRA** | **PRGF** | **Total** |
| January 2006 | N/A | 107.46 | 107.46 |

**Implementation of Catastrophe Containment and Relief (CCR):** Not Applicable.

**Safeguards Assessment:** An updated safeguards assessment of the BCH is underway. The previous assessment found that the BCH Law continues to pose a significant risk to central bank autonomy and that the bank's Board and audit committee do not have any independent members, which undermines these bodies' oversight function. The assessment recommended amendments to the BCH Law to protect the bank from political interference, establish its financial autonomy, and strengthen its governance arrangements. The assessment also recommended that the BCH adopt International Financial Reporting Standards (IFRS). While the BCH Board approved a plan to adopt IFRS for FY 2018, the implementation is significantly delayed.

[1] World Bank Board, July 6, 2000.

[2] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

## Nonfinancial Relations

***Exchange Rate Arrangement:***

Honduras' *de jure* exchange rate arrangement is classified as a crawling. The *de facto* exchange rate arrangement is classified as a crawling peg since July 2011, when the Central Bank of Honduras (BCH) reactivated the arrangement that had been in operation until mid-2005.

- Honduras has three possible exchange rates at any given time: (i) the one from the BCH FX auction, (ii) the one from the FX interbank market, and (iii) the official exchange rate (TCR—*Tipo de Cambio de Referencia*).

- Transactions at the BCH foreign exchange auction and at the foreign exchange interbank market take place according to prices that are within a band established by the BCH as ±1 percent above or below the average of base price for the preceding seven auctions.[3]

- The official exchange rate of the lempira (TCR) is calculated daily as the weighted average of the exchange rates in transactions made in the preceding business day at the BCH's foreign exchange auction and at the interbank foreign exchange market. The daily TCR is used for (i) sales of foreign exchange by authorized dealers to the BCH, (ii) sales and purchases of foreign exchange by authorized dealers from their clients, and (iii) sales and purchases of foreign exchange between the public sector and the BCH.

Honduras has accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and currently maintains two multiple currency practices subject to Fund approval under Article VIII, Section 3:

- One MCP arises because there is no mechanism to prevent a potential deviation of more than 2 percent between the TCR of the day at which certain transactions take place and the exchange rates at which foreign exchange is sold at the FX auction or the FX interbank market at that day.

- A second MCP arises from the possible use of previous days' official exchange rates (TCR) in certain exchange rate transactions (e.g. in FX sales by authorized dealers to the BCH of amounts bought from customers or amounts that exceed the limits set by the BCH for such dealers) which rates may potentially deviate by more than two percent from the TCR and the interbank market rate on the day when foreign exchange rate transactions take place.

**Last Article IV Consultation:**
On May 30, 2018 the Executive Bard concluded the 2018 Article IV Consultation.

[3] The base price is the outcome of the peg formula which takes into consideration: (1) the differential between the inflation rate and the inflation rates of trading partners, (2) changes in the nominal exchange rates of these partners' currencies *vis-à-vis* the U.S. dollar, and (3) the reserve coverage ratio which defines the size of the interaction between (1) and (2) that is translated into the base price.

**FSAP, FSSR participation and ROSCs**. Fiscal ROSC conducted on February 26–March 2, 2001 (IMF Country Report No. 02/16) and updated (IMF Country Report No. 05/256). Data ROSC data conducted on July 8–24, 2003 (IMF Country Report No. 05/230). FSAP conducted on October 14–19, 2002 and January 20–February 4, 2003. FSAP Update conducted on September 24 to October 9, 2007. FSSR conducted on June 8-9 and July 11-22, 2016.

**Technical Assistance:**

Honduras has received substantial technical assistance. The table below details assistance provided by department since January 2015.

| Department | Purpose | Time of Delivery |
|---|---|---|
| LEG | Legal Framework for Bank Resolution | May 2016 |
| | Governance Diagnostic | March, June 2019 |
| MCM | FX Lending Prudential Requirements | Feb 2015 |
| | CAPTAC-DR: Strengthening Monetary Policy Framework | Feb 2015 |
| | Financial Supervision | March 2015 |
| | Strengthening Monetary Policy Operational Framework | May 2015 |
| | CAPTAC-DR: Risk Based Supervision Implementation | May, June 2015 |
| | Domestic consolidated supervision | June 2015 |
| | CAPTAC-DR: Strengthening and Expanding the Macroeconomic Model | August 2015 |
| | Operational risk supervision | August 2015 |
| | Modernizing the Foreign Exchange System | Sep 2015 |
| | CAPTAC-Strengthening Capacities for Financial Stabilities Analysis | Sept 2015 |
| | FSSR Scoping Mission | January 2016 |
| | Regional Macroprudential Policies, Central America Countries | January 2016 |
| | Macroprudential policies | January 2016 |
| | CAPTAC: Training on Macroeconomic Forecast Models | February 2016 |
| | Operational risk supervision | February 2016 |
| | CAPTAC: Forecast Efficiency of the Central Bank´s Semi-Structural Macroeconomic Model | March 2016 |
| | CAPTAC: Support capacity building projection and economic analysis | April 2016 |
| | Stress testing models for credit risk with data panel | April 2016 |
| | Risk-based supervision | April 2016 |
| | Financial Sector Stability Review (FSSR) | July 2016 |
| | Modernization of the Monetary Policy Framework: Scoping mission | July 2016 |
| | Liquidity risk regulation | August, November 2016 |

| Department | Purpose | Time of Delivery |
|---|---|---|
| MCM | Strengthening of the credit, market and liquidity off-site supervision | September 2016 |
| | Modernization of the Monetary Policy Framework: Roadmap | September 2016 |
| | Enhancing the monetary policy operational framework and liquidity management | October 2016 |
| | Strengthening of the credit, market and liquidity off-site supervision | February 2017 |
| | Strengthening the stress testing framework for credit risk | March 2017 |
| | Monetary Policy Modernization: Inflation targeting roadmap and FPAS work plan | May 2017 |
| | CAPTAC: Strengthening the Monetary and Exchange Rate Policies Operational Frameworks | June 2017 |
| | CAPTAC: Stress Test | February 2018 |
| | Adoption of International Financial Reporting Standards (IFRS) | March 2018 |
| | Securities Market and Supervision | July, September 2018 |
| | CAPTAC: Financial Supervision | July, August, September 2017, March 2018, May 2019 |
| | CAPTAC: Operational Risk | November 2018, March 2019 |
| | Monetary policy modeling | November 2018 |
| | CAPTAC: Market risk and IRRBB | December 2018; February 2019 |
| | FPAS review | May 2019 |
| | Modernization of exchange rate policy and operations, and monetary policy implementation | May 2019 |
| FAD | Medium-term expenditure framework | March, July, November 2015 |
| | Treasury Single Account | July, October 2015 |
| | CAPTAC: Degree of maturity of government paper | July 2015 |
| | CAPTAC: Strengthen control of VAT credit | May, December 2015 |
| | Introducing PBB to MDAs | August 2015 |
| | CAPTAC: Strengthen Audit Procedures | September 2015 |
| | Ex-post Inspection | October 2015 |
| | Tax Administration | October, December 2015 |
| | CAPTAC: Medium-term Expenditure Framework | January 2016 |
| | Treasury Single Account | February, June, August, November 2016 |

| Department | Purpose | Time of Delivery |
|---|---|---|
| FAD | Customs Administration | March, April, December 2016 |
| | Streamlining Tax Exemptions | March 2016 |
| | Tax Administration | April, May 2016 |
| | Strategic Change Management | April 2016 |
| | CAPTAC: Strengthen audit procedures | May, October 2016 |
| | Budget - Preparation | June 2016 |
| | Fiscal Risks | July 2017 |
| | Taxpayer Service Improvement | February, October 2017 |
| | Treasury Single Account | February 2017 |
| | CAPTAC: Strengthen control of VAT credit | March 2017 |
| | Budget - Preparation | March 2017 |
| | CAPTAC: Strengthen audit procedures | March, October 2017 |
| | Fiscal Risks | April 2017 |
| | CAPTAC: Customs Administration | April, October 2017 |
| | CAPTAC: Tax Administration | January, February 2018 |
| | CAPTAC: Fiscal Statistics | December 2017 |
| | CAPTAC: Public Finance Management | April 2018 |
| | Tax Administration | June (CAPTAC), August, September (CAPTAC), October, November, December (CAPTAC) 2018, February, May 2019 |
| | CAPTAC: Strengthen tax audit | June, July 2018 |
| | CAPTAC: Treasury – Training plan | July 2018 |
| | Customs Administration | October 2018 |
| | CAPTAC: Budget | October 2018 |
| | CAPTAC: Implementation of new organizational structure | October 2018 |
| | CAPTAC: Risk Management | October 2018, April 2019 |
| | CAPTAC: Customs Administration (post clearance audit) | November 2018 |
| | Fiscal Transparency Evaluation | November 2018 |
| | Tax Policy | November 2018 |
| | CAPTAC: Treasury - TSA | January 2019 |
| | CAPTAC: Post Clearance Process | March, April 2019 |
| | CAPTAC: Workshop on Customs Intelligence | April 2019 |
| | CAPTAC: Strategic Planning | April 2019 |

| Department | Purpose | Time of Delivery |
|---|---|---|
| STA | Balance of Payments and IIP | Feb 2015 |
| | Topics of the Financial Account | March 2015 |
| | CAPTAC: National Accounts-Statistics and Construction Data Sources | May 2015 |
| | CAPTAC: Export and Import Price Index | May 2015 |
| | Balance of Payments and IIP | July 2015 |
| | External debt | July 2015 |
| | CAPTAC: Consumer Price Index | September 2015 |
| | CAPTAC: Balance of Payments | November 2015 |
| | CAPTAC: Quarterly National Accounts | January 2016 |
| | Balance of Payments and IIP | June-July 2016 |
| | Basic STA surveys and directories | March 2016 |
| | Enhanced General Data Dissemination System (e-GDDS) | March 2016 |
| | National Accounts Source Data | March 2016 |
| | National Accounts Statistics | April 2016 |
| | Special Surveys of Agricultural Products | April 2016 |
| | Financial Accounts – Cash Flow | April 2016 |
| | Balance of Payments | June 2016 |
| | CAPTAC: Non-observed Economy-Employment Matrix | July 2016 |
| | CAPTAC: National Accounts Rebasing Process | July 2016 |
| | CAPTAC: Improvements Quarterly Construction Survey-Revision of Sample Frames | March 2017 |
| | CAPTAC: National Accounts Rebasing Project | June 2017 |
| | CAPTAC: Non-observed Economy-Employment Matrix | August 2017 |
| | CAPTAC: Balance of payments and IIP statistics | March 2018 |
| | CAPTAC: National Accounts | May, June, July, September, November 2018; March, May 2019 |
| | CAPTAC: Government Finance Statistics | May, July 2018, May 2019 |
| | CAPTAC: Classifications | October 2018 |
| | CAPTAC: Quarterly data compilation and OSDS | January 2019 |

# RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Inter-American Development Bank: https://www.iadb.org/en/countries/honduras/overview

World Bank: http://www.worldbank.org/en/country/honduras

# STATISTICAL ISSUES

(As of June 24, 2019)

| I. Assessment of Data Adequacy for Surveillance |
|---|
| **General:** Data provided to the Fund are broadly adequate for surveillance and program monitoring purposes. However, monitoring will benefit from both better timing of data release and more comprehensive data coverage. Some issues that were flagged in the previous Article IV have not been fully addressed, including the lack of comprehensive data on the financial operations of public enterprises, enhancing reporting of government guarantees and fiscal contingent liabilities, and a valid and reliable methodology to estimate private capital flows. |
| **National Accounts:** The Central Bank of Honduras (BCH) compiles national accounts estimates following the *System of National Accounts 1993* (*1993 SNA*). The base year is 2000. The quarterly GDP data are consistent with the annual series. The BCH has developed a project to rebase the national accounts series to 2016, including the adoption of the main recommendations of the *2008 SNA*, with support of CAPTAC-DR, planned to be concluded by 2021.<br><br>**Labor statistics:** Honduras' National Institute of Statistics (INE) conducts its household survey annually which includes labor market information. More frequent data on employment and wages are required to better facilitate short-term policy analysis. |
| **Price Statistics:** The BCH prepares and publishes (since April 2000) the consumer price index (CPI), with reference period of December 1999. The selection of products included in the CPI basket and corresponding weights are based on the National Household Income and Expenditure Survey (NHIES) of 1998–99. A new NHIES for 2019 has been rolled out and is expected to be completed by end-2019. The BCH expanded the coverage of the producer price index and updated its base (to 2010) and classification, in the context of the last revision of the national accounts (base year 2000). The index, currently compiled for internal use, only includes goods for processing activities (maquila), trade and transport margins, which limits its use it in the compilation of national accounts at constant prices. |
| **Government Finance Statistics:** The Ministry of Finance (SEFIN) compiles and disseminates government finance statistics (GFS) covering central administration, central government, general government, and nonfinancial public sector. The above-the-line data of these sectors are reported to WHD, along with below-the-line data for central administration and nonfinancial public sector, which are provided by the BCH. Currently, the SEFIN and the BCH are participating in the GFS data enhancement project for Central America, Panama, and Dominican Republic. Under this project, country participants will elaborate and publish comparable GFS across countries to support decision making, permit a comparative analysis of fiscal developments and facilitate the regional policy dialogue. The components of the projects are: (i) compilation and dissemination of high quality sub-annual and annual data using the GFSM 2014 framework, and (ii) work towards the gradual implementation of the *Government Finance Statistics Manual 2014 (GFSM 2014)* and the *Public Sector Debt Statistics Guide (PSDSG)*. A mechanism is needed to systematically collect data on arrears and floating debt of public enterprises. |

| | |
|---|---|
| **Monetary and Financial Statistics:** Monetary and financial statistics (MFS) are reported to STA on a regular monthly basis using the standardized report forms (SRFs) for the central bank, other depository corporations, and other financial corporations (OFCs). However, pension funds are excluded from the coverage of OFCs. The inclusion of pension funds, and cross-sectoral data consistency between MFS and other data sets are the major issues that should be addressed. | |
| **Financial sector surveillance:** The authorities report 11 out of 12 core financial soundness indicators and five of the encouraged set. | |
| **External sector statistics:** Honduras has achieved significant milestones in the context of the CAPTAC-DR's Regional Harmonization Project of External Sector Statistics (ESS), which ended in December 2015. The BCH disseminates quarterly Balance of Payments and International Investment Position (IIP) statistics, and monthly the Data Template on International Reserves and Foreign Currency Liquidity. Honduras also participates in the Coordinated Direct Investment Survey (CDIS) and the Coordinated Portfolio Investment Survey (CPIS). Work in progress at the BCH aims at improving the coverage of nonfinancial private sector transactions and positions included in balance of payments and IIP statistics, ensuring consistency between external debt statistics and IIP statistics, and completing the migration to a BPM6 basis of recording and dissemination of ESS. | |
| **II. Data Standards and Quality** | |
| Honduras is an e-GDDS participant. In June 2016, it implemented the e-GDDS recommendations—including the launch of a National Summary Data Page to serve as a one-stop portal for essential macroeconomic and financial data. We encourage the authorities to take steps toward SDDS subscription. | Data ROSC was published on July 29, 2005. |

## Table of Common Indicators Required for Surveillance

(As of May 3, 2019)

| | Date of latest observation | Date received | Frequency of Data[7] | Frequency of Reporting[7] | Frequency of Publication[7] |
|---|---|---|---|---|---|
| Exchange Rates | 03/05/19 | 03/05/19 | D | D | D |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | 03/05/19 | 03/05/19 | D | D | D |
| Reserve/Base Money | 31/03/19 | 09/04/19 | D | M | D |
| Broad Money | 31/03/19 | 09/04/19 | M | M | M |
| Central Bank Balance Sheet | 31/03/19 | 13/04/19 | D | M | D |
| Consolidated Balance Sheet of the Banking System | 28/02/19 | 30/04/19 | M | M | M |
| Interest Rates[2] | 31/03/19 | 09/04/19 | W | M | M |
| Consumer Price Index | 30/04/19 | 03/05/19 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4] | 31/12/18 | 30/03/19 | Q | Q | Q |
| Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government | 31/12/18 | 30/03/19 | Q | Q | Q |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | 31/12/18 | 30/03/19 | Q | Q | Q |
| External Current Account Balance | 31/12/18 | 09/03/19 | Q | Q | Q |
| Exports and Imports of Goods and Services | 31/12/18 | 09/03/19 | Q | Q | Q |
| GDP/GNP | 31/12/18 | 09/03/19 | Q | Q | Q |
| Gross External Debt | 28/02/18 | 30/04/19 | M | M | M |
| International Investment Position[6] | 31/12/18 | 09/03/19 | Q | Q | Q |

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

**Statement by Leonardo Villar, Executive Director for Honduras**
**July 15, 2019**

Aided by a Fund-supported economic program from 2014 to 2017, Honduras managed to secure macroeconomic stability, mainly by implementing a front-loaded fiscal consolidation and by laying the groundwork for a modern policy framework. Fiscal deficit was reduced by 7 percent of GDP in three years, and the 2016 Fiscal Responsibility Law, overperformed since its enactment, institutionalized fiscal prudence.

As an anchor to support the policy reforms, address the remaining challenges, and build on past gains, authorities have requested a new Fund program—to be treated as precautionary. The main objective of the program is to maintain macroeconomic stability while enacting economic and institutional reforms to foster inclusive growth aimed at enhancing the quality of fiscal policy, improving governance and the business environment. The main elements of the program include: (1) reforms to increase the quality of fiscal policy, mainly by securing financial sustainability of the public electricity company (ENEE) as well as sustaining revenue mobilization efforts and protecting investment and social spending, (2) continued progress to modernize the monetary policy framework, 3) efforts to strengthen governance and AML/CFT, bolster anti-corruption initiatives, and improve the business climate.

## Fiscal Policy

The government's fiscal policy will continue to be guided by the FRL in coming years. This will be instrumental in maintaining confidence and keeping Honduras' risk premium low, reducing financing costs for the economy. Relatedly, in June 2019, Moody's maintained Honduras' rating at B1 with a stable outlook.

However, challenges in the fiscal front remain, in particular in the electricity sector, revenue mobilization, fiscal transparency and governance. The proposed program will help Honduras address these challenges.

### *1. Electricity Sector*

Authorities are committed to address the long-standing challenges in the electricity public company, ENEE. The structural overhaul of the electricity market is critical and represents a cornerstone in the authority's economic program. Because of its complexity, this will take time and be gradual. The general framework law of the electricity sector was enacted in 2014 (although still not fully implemented) a very positive development at this juncture as no further related legislation is pending in Congress. An important component of the overhaul is its implementation to achieve the rehabilitation and upgrading of the sector's infrastructure, including appointing the system operator in charge of managing the power grid to ensure reliable delivery of electricity, which will contribute to foster private investment. Notably, the first steps in this endeavor have already been taken.

All prior actions considered in the proposed program for the electricity sector reform have already been met. The periodic tariff adjustment aligned with the energy reduction cost were being modified before the program started, and the plans to secure financial sustainability for ENEE and to reduce electricity losses have been drawn out.

The reform plan is designed to include the following:

- *Unbundling of the company*. As mandated by the electricity framework law and with technical support from the Inter-American Development Bank, ENEE will be unbundled into three independent companies—generation, transmission, and distribution. This segregation should improve governance, gradually facilitating needed investment in the electricity sector.

- *Addressing financial and generation issues.* Authorities plan to reach market-friendly restructuring agreements with ENEE's creditors to reduce financing costs. Additionally, in strict adherence to the legal framework, they will seek a more efficient generation—including revision of approved contracts not yet in operation.

- *Reducing electricity losses*. Authorities will review the strategy to reduce electricity losses both in transmission and distribution. As part of this, they will (i) revise, following due process, the contract with Empresa Energía Honduras (EEH)—the operator of the distribution system—to strengthen an effective loss-reduction plan; (ii) deploy a law enforcement task force to prevent theft and fraud; and (iii) continue upgrading the metering infrastructure.

Authorities are conducting a full review of arrears that ENEE has accumulated to private operators and will gradually clear them.

### *2. Revenue Mobilization*

The authorities are committed to maintaining the gains of the recent revenue mobilization efforts which will require several tax policy and administrative measures, such as: (i) streamlining exemptions while protecting the poor; (ii) propose legislative changes to return control and verification procedures for tax exemptions -now held by the Ministry of Finance- to the Tax Administration Office (SAR). Additionally, the creation decree for the new customs administration (temporarily COPRISAO) will be enacted, an electronic notification procedure for taxpayers will be introduced, and SAR's systems will be upgraded to modernize based on timely tax refunds. Furthermore, SAR, the Ministry of Finance, and COPRISAO will sign an agreement at the end of July to share information on a timely basis.

### *3. Fiscal Transparency and Trust Funds*

Authorities are committed to enhancing the quality of public expenditure and will implement the recommendations of the Fiscal Transparency Evaluation (FTE) recently conducted by the Fund, which will be published shortly. Benchmarking of Honduras' reporting, projections and risk management against the Fund's fiscal transparency code suggests that most practices are consistent with the FTE, but it helped identifying areas for improvement, notably regarding trust funds.

On trust funds, authorities will take steps to transfer well-established programs to the budget and include an annex on spending by trust funds in the 2020 budget proposal to Congress.

Also, a mandatory assessment by the Ministry of Finance will be set up as a pre-condition for contracting debt by trust funds. Starting with the 2021 budget, authorities will present a plan to execute spending currently channeled through social and infrastructure trust funds under full public financial management regulations.

### *4. Governance and Procurement*

Technical assistance on governance that included issues such as procurement and the selection of public investment projects ended in June 2019. The authorities, committed to strengthening governance, plan to evaluate the recommendations and develop a plan to address them which will be discussed during the first review of the program.

## Monetary Policy

The Central Bank of Honduras (BCH) stands ready to maintain inflation within the target range (as it did in January 2019 when it hiked the policy rate, the first time since 2012) and to maintain an adequate level of international reserves. BCH authorities will continue to improve the operational framework for conducting monetary policy, seeking the implementation of full-fledged inflation targeting in coming years. To meet this goal, a new central bank charter will be submitted to Congress by December 2019, supported by continued technical assistance from the Fund. The new charter aims to safeguard operational autonomy, increase transparency and accountability by making price stability the policy mandate of the BCH, introducing the International Financial Reporting Standards, securing a sound central bank governance structure, and clarifying responsibilities for operational, oversight and policy decision.

As of May 2019, Honduras has liberalized 30 percent of the foreign exchange market. The exchange rate policy will include gradual steps towards a flexible exchange rate regime. A plan will be presented for the gradual removal of the remainder 70 percent foreign exchange surrender requirements (obligation to sell export proceeds to BCH) by December 2019.

As part of the transition towards full-fledged inflation targeting, authorities are working to improve statistics on pricing and economic activity that are critical for monetary policy decision making. Authorities will complete the National Household Income and Expenditure Survey by September 2020, with the goal of publishing a new consumer price index by December 2021. Additionally, a new national accounts series will be published by December 2021, rebasing the national accounts series to 2016.

## Financial Policies

The supervisory authority has continued to improve regulatory framework and supervisory practices in line with the FSSR recommendations and the Basel III standard. It plans to establish a timeframe for the introduction of an additional capital charge for systemic banks, assess improvements to the investment policy framework of public pension funds and will work with Congress to approve a new securities market law to support the development of domestic capital markets. It will remain vigilant to tightening the macro-prudential framework depending on the evolution of credit growth, especially in foreign currency. It is worth noting that, as projected by authorities, foreign currency credit from the banking system to the private sector has decelerated in 2019, reaching a y/y growth of 9.3 percent in May 2019 down from a high of 21.5 percent in August 2018.

The public agricultural development bank (BANADESA) was created by a special law that limits the actions of the supervisory authority, and its financial deterioration has been brought up to Congress for several years now. The reforms made to the new Financial Sector Law in 2017, provided new tools that made it possible for the supervisory authority to seize BANADESA's administrative and operational control to protect depositors and operations. The authorities will follow the procedure envisaged in the financial sector law, which requires the CNBS to submit a report to Congress, including a proposal to address the financial situation of the bank by September 2019.

**Social Policies**

Reducing the high poverty rate is one of the main objectives of the current government, accordingly, it will expand its flagship cash-transfer program "*Bono Vida Mejor*", (aimed at covering population in extreme poverty by end-2021) which according to a study done by the IDB has been successful in reducing the intergenerational transmission of poverty. Significant and ongoing progress in the fight against violence over the last years has resulted in a sharp decline in violent crime, but this continues to be a challenge. Both high poverty and violence aid fueling migration; to counter these authorities have assigned a task force within the state department, the Social Development Ministry, and the Human Rights Ministry to articulate a comprehensive effort to assist potential and returning migrants, which is going to complement the FOSMIH -an existing fund to support Honduran migrants.

As raising female labor participation is critical to boost potential growth, the authorities' strategy will combine new programs with ongoing initiatives to improve opportunities for women by supporting childcare services, facilitating credit for women, and supporting women with young children.

**Business Environment**

To foster the private sector, ongoing administrative simplification and a one-step window are being implemented for international trade. Furthermore, legislation requiring public regulatory agencies to streamline and advertise requirements for obtaining permits, and to reduce discretion and speed up approvals will be submitted to Congress. Additionally, to simplify public administration procedures, electronic signature will be introduced.

The supervisory authority has continuously strengthened their AML/CFT framework following recommendations of the Financial Action Task Force of Latin America (GAFILAT). In line with this, coverage of Designated Non-Financial Businesses and Professions (DNFBPs) will be expanded. Additionally, a plan for identification of shareholders and beneficial owners of incorporated companies for AML/CFT purposes, is being evaluated.

## Trade Policy

Honduras and Guatemala are part of a customs union that went into effect in 2016 and allows free circulation of around 80 percent of goods traded between the two countries; El Salvador joined the union in August 2018. The customs union will support greater integration among these countries. Honduras is also strengthening its ties with Asia-Pacific economies, recently finalizing a free-trade agreement (FTA) with South Korea that is likely to come into effect by end 2019.

## Final Remarks

Supported since 2014 by a Fund program that expired in 2017, Honduras made great strides in reducing macroeconomic imbalances and improving confidence, institutionalizing fiscal prudence and strengthening its policy framework. To build on previous achievements and make progress in solving long-standing issues, authorities have requested a new Fund program -precautionary – as an anchor to support reforms and address remaining vulnerabilities and risks, including still high level of poverty, the deteriorating financial situation of ENEE, and the continued need to strengthen the macroeconomic policy framework, and improve governance and the business environment. On behalf of our Honduran authorities, we thank staff, Management and the Executive Board for the consideration of this program.